

Washington State Auditor's Office

Audit Report

Washington State Migrant Council Yakima County

Special Audit

Audit Period

November 1, 1996 through October 31, 1997

Report No. 6045

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Brian Sonntag

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Scope and Opinion

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

This report represents the results of our audit of the financial and grant accounting records of the Washington State Migrant Council (the Council) during the period November 1, 1996, through October 31, 1997. This audit was performed at the request of the Washington State Legislature.

A special focus of our audit dealt with the method the Council used to combine funding from three federal and state agencies into a single program. This program delivers services to basically the same population of children from migrant and seasonal farm worker families during the same period of time.

The purposes of our audit were to determine if:

- The Council complied with applicable federal and state laws and regulations and its own policies, established an effective system of internal control over federal and state funds, maintained adequate financial and grant accounting records and spent tax dollars for purposes specified in its grant agreements and contracts.
- Federal and state agencies adequately monitored the Council's compliance with agreements and contracts.
- Federal and state laws and regulations ensure that organizations such as the Council are accountable for the tax dollars provided to them and that funds are spent for authorized purposes.

The audit included tests of the accounting records and other auditing procedures we considered necessary in the circumstances. It was performed pursuant to Chapter 232, Washington Laws of 1998, *Audits of Nongovernmental Entities With State Contracts*, an act pertaining to audits of state contractors by the State Auditor's Office under the authority of Chapters 43.88 and 43.09, *Revised Code of Washington*.

The nature of our audit did not prompt us to issue an opinion on the completeness or accuracy of the Council's financial statements.

As required by generally accepted auditing standards and for audit efficiency, we relied on relevant work performed by other federal and state program reviewers and auditors as well as by the Council's auditor.

In our opinion, as detailed in the accompanying schedule of audit findings:

- The Council received excess funds from federal and state agencies, used adjusting journal entries to transfer expenses from restricted grant programs to another grant program it believed was unrestricted, and did not maintain appropriate time and effort

records for payroll costs charged to federal and state grants. The Board of Directors also did not effectively review the Council's financial activities.

- Federal and state agencies need to improve subrecipient monitoring procedures to ensure the Council complies with applicable laws, regulations, grant agreements and contracts.
- Federal and state laws and regulations governing organizations such as the Council need to be improved to ensure accountability for public funds.

Audit Summary

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

ABOUT THE AUDIT

This report contains the results of our first audit of the Washington State Migrant Council (the Council) during the period November 1, 1996, through October 31, 1997. This audit was performed at the request of the Washington State Legislature.

Our work focused on determining whether the Council complied with state laws and regulations, federal and state grant requirements and its own policies and procedures. We evaluated internal controls established by management. We also performed audit procedures on specific areas that had the potential for abuse or misuse of public tax dollars.

A special focus of our audit dealt with the method the Council used to combine funds from three federal and state agencies into a single program. These three grants are Migrant Head Start (MHS), Seasonal Child Care (SCC) and the Migrant Education Program (MEP).

RESULTS

Our extensive audit tests of the Council's disbursement transactions during fiscal year 1997 found no fraud, misconduct or malfeasance.

Federal and state agencies agree that the quality of services can be improved through a blended resources program. However, we believe the Council received at least \$6.7 million in excess funds from federal and state agencies for its blended resources program. While joint reviews and audits of the Council's blended resources program have been conducted since 1997, federal and state agencies initially did not effectively communicate with each other and the Council to ensure success in accounting for and administering grant funds. While the Council believed its method of operating the blended resources program had been properly disclosed, the agencies and the Council maintained different interpretations of the contracts and agreements for the three grants involved. MEP funds have not been used at the Council in program year 1999. The remaining agencies providing funds for the Council's blended resources program, HHS and DSHS, need to collaborate with the Council to resolve the issues discussed in this report.

Our brief on-site review of child care operations at the Child Development Centers found that the Council appeared to provide quality services to migrant and seasonal farm worker families.

While delivery of services is why the Council exists, administering and managing grant programs and reporting on the Council's financial activities also are critical stewardship

responsibilities. The Council must demonstrate to federal and state agencies and to its contract auditor that it is accountable for the tax dollars it receives. If a grantee does not properly manage its programs and produce accurate financial reports, future funding for services may be jeopardized.

The Council has established internal controls to effectively operate the Council, safeguard resources, produce reliable financial reports and comply with applicable laws and regulations. However, we found that managers were able to override these internal controls when processing adjusting journal entries to transfer certain expenses from restricted grant programs to another grant program the Council believed was unrestricted. The Council believed these unrestricted funds could be used for any organizational purpose. As a result, the Council's expenditure records and reports for each affected program are not accurate or reliable.

One major issue described in this report deals with determining whether the Council is a vendor or a subrecipient of federal funds received from the Department of Social and Health Services (DSHS). This determination affects how DSHS monitors its Seasonal Child Care contract with the Council. We believe the Council is a subrecipient because it determined who was eligible to receive services, to what degree, and in what manner. However, DSHS contracted with the Council as a vendor. DSHS has asked the U.S. Department of Health and Human Services (HHS) to clarify this issue, and understands that HHS has consulted with the U. S. Office of Management and Budget (OMB) about the matter (see finding number 6). Therefore, this issue remains unresolved as of the date of this report.

Federal and state agencies have cited certain problems during Council reviews prior to our audit. In response, the Council has taken steps to make improvements. However, this audit indicates that additional work is needed. Our audit found areas where improvements could be made at all organizational levels reviewed, including the Council, state agencies, HHS, and in the audit guidance published by OMB.

We will provide a copy of this audit report to the Task Force on Agency Vendor Contracting. The Task Force was created by the Legislature in 1998 to study state social services contracting practices and to make recommendations for improving management of fee-for-service and client-services contracts with non-profit organizations providing social services. The Task Force is currently working with key legislators, state agency personnel, non-profit organizations, and other interested parties to assess how the state can effectively and efficiently address situations where multiple agencies provide funding to organizations such as the Council. The Task Force's report is due to the Governor and Legislature on November 1, 1999.

This report includes the following eight audit findings:

- The Council received or was awarded at least \$6.7 million in excess funds from federal and state agencies for its blended resources program. The Council disputes this position.
 - 1) The Council received or was awarded at least \$3 million in excess funds due to the under-enrollment of children in the Migrant Head Start (MHS) program in fiscal year 1997.

- 2) The Council received at least \$1.5 million in excess funds for services in the Seasonal Child Care (SCC) program in fiscal year 1997. DSHS maintains that any overpayment made to the Council for child care services would have been by HHS rather than by DSHS. HHS Migrant Head Start program staff disagree with DSHS's position. This issue remains unresolved.
- 3) OSPI also questioned approximately \$2.2 million in Migrant Education Program (MEP) costs at the Council during the five-year period from July 1, 1993, through June 30, 1998. OSPI reported that the Council used average daily attendance counts for funding purposes, rather than counting only eligible children, and inadvertently used an inappropriate salary distribution system for payroll expenses charged to MEP. This condition was indirectly caused by OSPI when it inadvertently approved a salary distribution system for the Council that was not allowed by OMB Circular A-122, *Cost Principles for Non-Profit Organizations*.

Summary of Responses

The Council strongly disagrees with this finding and believes the underlying premise is inaccurate. It believes blending of funding is crucial to the ability of any entity to provide high quality services that are responsive to the needs of children and families. It also maintains that no program paid for the same service that another program had paid for. The Council disagrees that the MHS program is significantly under-enrolled and states that it had an unused fund balance of \$900,000 for the year. It also stated that peak enrollment was almost 2,000 children, and that services to 773 children were extended into the month of October. It maintains that, to the extent that surplus funds existed in any year from the SCC program, it spent those funds on facilities, equipment and services consistent with its mission to serve migrant and seasonal families. The Council elected not to comment on the MEP on the advice of legal counsel. The Council plans to appeal OSPI's disallowance of \$1.9 million of the \$2.2 million in questioned costs.

HHS is in agreement with all findings in this report except for finding number one. While it agrees in principle on the importance of having open lines of communication between funding sources as stated in this finding, it does not agree with the assumption that the problems experienced by the Council had to do with a lack of communication between funding sources. HHS believes that the problems revolved around weak or non-existent fiscal control systems, lack of grant oversight by the Council's Board of Directors, and management's practice of journal entry adjustments. The lack of clarity for the Council's subrecipient status of Title XX funds also contributed to the problem.

DSHS agrees that state and federal agencies must strengthen their working relationships when purchasing services from entities that pool resources to provide critical services to Washington residents. It is committed to making that happen and is working with the Federal Migrant Head Start Bureau to resolve these issues. At issue in this finding is the determination of who has the authority to pursue recovery of an amount billed by the Council to the SCC and MHS programs for the same service. DSHS cites federal regulations which indicate that any payments made for child care by the state should reduce the reimbursement that the Council receives under the MHS program. Thus, any overpayment for excessive billings of child care services would be attributable to the MHS program, and that program would have the authority to recover such overpayments. But, this issue remains unresolved with HHS. DSHS will seek a

prompt determination from HHS on the applicability of the federal regulations. If a final determination is made that these regulations do not apply to the MHS funds received by the Council, then DSHS will pursue recovery of any amounts determined to have been billed in excess of actual services provided.

OSPI agrees that the Council received federal funds to which it was not entitled as a result of a failure to meet OSPI contract requirements. It plans to implement the recommendations outlined in the report.

- The Board of Directors needs to improve its review of the Council's financial activities.

Summary of Response

***The Council** disagrees with the finding because, in its view, the criteria cited was not applicable during the audit period. However in response to this finding, it has re-designed the financial reports in the package of information that it provides to the Board of Directors. It rejects the implication that its Board is merely a "rubber stamp" for management.*

- The Council used adjusting journal entries to transfer expenses from restricted grant programs to another grant program it believed was unrestricted. The Council has established internal control procedures to properly process and record expenditure transactions in the accounting system. However, Council managers were able to override the internal controls by using adjusting journal entries to transfer expenses between grant programs. The Council believed these unrestricted funds could be used for any organizational purpose. As a result, the Council's expenditure records and reports for each affected program are not accurate or reliable.

Summary of Response

***The Council** disagrees with this finding. Since the finding addresses less than two percent of the total transactions it conducts each year, it questions whether the amount is material. The Council also sees nothing wrong with using its unrestricted funds to subsidize other government programs.*

- The Council needs to maintain appropriate time and effort records for payroll costs charged to federal and state programs. This condition affects all Council employees whose payroll costs are allocated to more than one grant.

Summary of Response

***The Council** stated that it instituted a time and effort system approved by OSPI. However, the Council has implemented a new system which is fully compliant with state and federal regulations.*

- DSHS needs to ensure an adequate segregation of duties in the SCC program. DSHS contracted with the Council to determine the eligibility of children of seasonal farm worker families, decide how to provide the services to these children, deliver the actual child care services and then authorize payments to itself for performing the services.

Summary of Response

DSHS agrees that internal controls should be improved to ensure adequate segregation of duties. It has also amended its contracting practices and increased monitoring activities.

- DSHS needs to adequately monitor the Council's programs and financial activities. Major issues include the following:
 - 1) No agency accepted the cognizant agency role for the Council. A state agency that provides the majority of federal assistance to a grantee, such as DSHS, could have also designated itself as the cognizant agency for that organization. By doing so, it would assume the responsibility for implementing single audit requirements and coordinating audit follow-up for the grantee.
 - 2) DSHS did not perform subrecipient monitoring tasks in the SCC program during the period April 1985 to November 1997, because it determined that the Council was a vendor rather than a subrecipient. However, DSHS did state that it reviewed the Council's single audit reports.
 - 3) Since DSHS determined that the Council was a vendor rather than a subrecipient, DSHS did not obtain the required advance approval from the U.S. Department of Health and Human Services (HHS) when the Council spent \$835,856 to acquire land, equipment and buildings with federal funds. In addition, the Council was not aware that it had received federal funds from DSHS.

Summary of Responses

OFM stated that much of the State Auditor's recommended guidance already exists at the state and/or federal level. In spite of these regulations, policies and guidelines, the situation at the Council occurred because implementation of guidelines broke down. The Council overrode required internal controls and the Single Audit failed to report on the lack of operational internal controls. DSHS followed existing federal regulations and made a good faith determination that the Council was a vendor, not a subrecipient.

Nevertheless, OFM recognizes that there is always room for improvement. Accordingly, OFM has increased emphasis in training classes on the criteria for making subrecipient/vendor determinations as well as the responsibility for monitoring when an organization is determined to be a subrecipient. OFM is working with the Task Force on Agency Vendor Contracting that was established by the 1998 Legislature. The Task Force is studying state social services contracting practices and is to provide recommendations for improving the management of contracts with non-profit organizations. OFM will also encourage state agencies to improve communications with other funding agencies when multiple federal and state agencies fund delivery of services by contracting organizations.

DSHS does not concur with the basis for this finding. But, it changed contract language to clarify the vendor relationship and increased monitoring activities. DSHS maintains that the primary basis for the finding hinges on the determination of whether the Council

is a vendor or a subrecipient. DSHS made the vendor determination in good faith under a reasonable interpretation of the contract as guided by OMB Circular A-133. DSHS has been working with HHS to resolve this issue since September 1998. However, the issue still remains unresolved. DSHS also maintains that there is no requirement for it to assume the responsibility of a cognizant agency.

- HHS needs to promptly resolve findings from prior reviews of the Council's MHS program. Unresolved problems included nepotism, under-enrollment of children, an unapproved cost allocation plan and insufficient funds for matching contributions from other sources.

Summary of Response

HHS agrees with this finding.

***The Council** stated that it has received a February 9, 1999, letter from HHS which approved its nepotism policy and procedures, employee transfers and employee waivers.*

- The guidance for audits of organizations that receive federal and state awards needs to be improved. OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, does not permit closely related programs with dissimilar compliance requirements to be audited as a cluster. Thus, while grantors and the contract auditor reviewed major programs separately, no one looked at the complete picture or considered the full impact of the three federal and state grants where the Council combined funds into a single program.

Summary of Responses

***OMB** does not respond to recommendations included in audits of non-Federal entities.*

***OFM** agrees that it would have been beneficial for the awarding federal and state agencies to have coordinated service delivery by the Council to ensure all parties agreed on what services were to be provided by what funding source. OFM will work with the Task Force on Agency Vendor Contracting in an effort to devise a workable, affordable approach to coordinating multi-agency funding situations.*

Description of the Migrant Council

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

ABOUT THE MIGRANT COUNCIL

The Washington State Migrant Council (the Council) was incorporated on July 18, 1983, as a non-profit corporation in the state of Washington. The Council is tax-exempt. Carlos M. Diaz, Executive Director, is the registered agent for the corporation. The executive director controls and directs the Council's overall activities and operations. The Council was formed after a predecessor organization, Northwest Rural Opportunities, was dissolved in 1983.

The Council's primary activity is to provide child care and educational, health and nutritional services to children of low-income migrant and seasonal farm worker families in the state of Washington. According to the Council's audit report, its mission is to improve the quality of life for the children it serves through the promotion, coordination and implementation of comprehensive, bilingual, bicultural, educational, social, economic, health and human service opportunities.

The Council receives virtually all of its funding from 28 federal and state programs and is one of the largest private non-profit social service agencies in the state of Washington. It operates 26 centers throughout the state and employs between 275 and 1,000 people, depending on the agricultural season.

ELECTED MEMBERS OF THE BOARD OF DIRECTORS

The Council is governed by a Board of Directors (the Board). Board members have job descriptions and are asked to adhere to a code of ethics. These documents state that the Board develops policies, procedures and regulations for the operation of the Council and monitors finances of the organization, its programs and performance.

The Board has nine members as follows:

- Seven board members serve staggered, three-year terms.
 - a. Six members are selected to represent the regions of the state where the Council operates. These members are recipients of Council services.
 - b. One member is selected to represent one of the following: a private business, the financial sector, a community organization or a state funded agency.
- Two board positions serve annual terms.
 - a. One member represents the Migrant Head Start Policy Council.

- b. One member represents the Early Childhood Education Program.

All members of the Board must demonstrate a commitment to the welfare of migrant and seasonal farm workers.

As of August 1998, the members of the Board were as follows:

<u>Name</u>	<u>Position</u>	<u>Remarks</u>
Oscar Galvan	Chair	
Israel Rodriguez	Vice-Chair	Resigned
Maribel Aliniz	Secretary	
Rey Candia	Treasurer	
Hector Ahumada	Sergeant of Arms	
Marco Antonio Blanco	MHS Policy Council Representative	
Jose Corona	Member	
Belinda Razo	Member	
Felix Pascual	Member	

MIGRANT HEAD START POLICY COUNCIL

A Migrant Head Start Policy Council is elected annually. It has 29 members, including 25 representatives from the eligible migrant parent population and 4 representatives from the community.

APPOINTED COUNCIL OFFICIALS

<u>Name</u>	<u>Position</u>	<u>Remarks</u>
Carlos M. Diaz	Executive Director	
Dawn Rasmussen, CPA	Director of Administration and Budget	Resigned
Sean Bleck	Attorney (Seattle, WA)	
Edward T. Waters	Attorney (Washington, D.C.)	
Jean Pryor, CPA	Council's Auditor (Yakima, WA)	

MAILING ADDRESSES

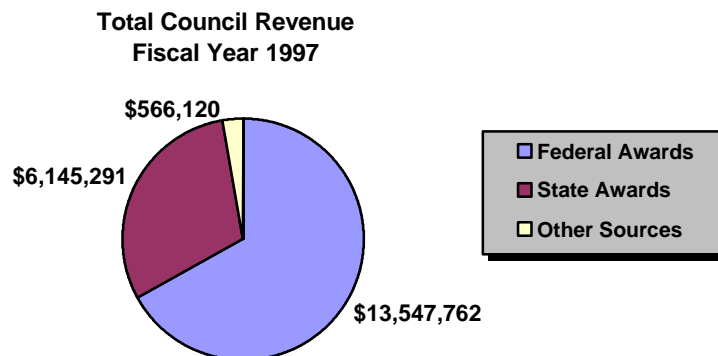
<u>Organization</u>	<u>Address</u>
Council	301 North First Street, Suite 1 Sunnyside, WA 98944 (509) 839-9762
Attorney	Isenhour Bleck, PLLC Union Bank of California Center, Suite 3250 900 Fourth Avenue Seattle, WA 98164-1005 (206) 340-2200

Attorney	Feldesman, Tucker, Leifer, Fidell & Bank, LLP 2001 "L" Street N. W., Second Floor Washington, D. C. 20036-4910 (202) 466-8960
Auditor	Moss Adams, LLP 212 North Naches Avenue P. O. Box 22650 Yakima, WA 98907-2650 (509) 248-7750

COUNCIL REVENUE

For the fiscal year ended October 31, 1997, the Council's audited financial statements reported revenue in excess of \$20 million. Funding for the Council is primarily from government grants and contracts, and the Council's existence depends on the continuation of this funding.

This chart depicts the sources of the Council's revenue by major category:



Total \$20,259,173

Table 1, showing the source of all Council revenues for the fiscal year ended October 31, 1997, follows.

WASHINGTON STATE MIGRANT COUNCIL
TABLE 1 - COUNCIL REVENUES
FOR FISCAL YEAR ENDED OCTOBER 31, 1997

GRANTOR/PROGRAM SOURCE	TYPE OF REVENUE	REVENUE RECEIVED
FEDERAL AGENCIES		
U.S. Department of Health & Human Services		
Migrant Head Start	Federal only	\$10,050,276
Region X Head Start	Federal only	1,142,096
Early Head Start	Federal only	603,697
Runaway and Homeless Youth	Federal only	57,904
Total		\$11,853,973
U.S. Department of Labor		
Migrant/Seasonal Farmworker	Federal only	1,659,778
U.S. Department of Education		
Vocational Rehabilitation Services	Federal only	31,335
Projects with Industry	Federal only	2,676
Total		<u>34,011</u>
TOTAL FEDERAL AGENCIES		<u>\$13,547,762</u>
STATE AGENCIES		
Department of Social & Health Services		
Seasonal Child Care	Federal and state combined	\$2,474,675
JOBS	Federal only	29,575
Infant & Toddler		
Early Intervention	Federal only	28,025
Total		\$2,532,275

WASHINGTON STATE MIGRANT COUNCIL
TABLE 1 - COUNCIL REVENUES
FOR FISCAL YEAR ENDED OCTOBER 31, 1997

GRANTOR/PROGRAM SOURCE	TYPE OF REVENUE	REVENUE RECEIVED
Department of Community, Trade & Economic Development (CTED)		
Early Childhood Education and Assistance	Federal and state combined	\$1,667,987
Food Stamp Outreach	Federal and state combined	148,090
Head Start Matching	State only	93,632
Youth Shelter	State only	21,558
Total		\$1,931,267
Office of the Superintendent of Public Instruction (OSPI)		
USDA Food	Federal only	798,967
Migrant Education	Federal only	393,925
Project Even Start	Federal only	168,790
Parent Involvement	Federal only	45,038
Summer Food Program	Federal only	5,750
Total		1,412,470
Department of Health		
Women, Infants & Children	Federal and state combined	245,196
State Board for Community & Technical Colleges		
English as a Second Language	State only	24,083
TOTAL STATE AGENCIES		\$6,145,291

WASHINGTON STATE MIGRANT COUNCIL
TABLE 1 - COUNCIL REVENUES
FOR FISCAL YEAR ENDED OCTOBER 31, 1997

GRANTOR/PROGRAM SOURCE	TYPE OF REVENUE	REVENUE RECEIVED
OTHER SOURCES		
Private Donors	Private only	\$251,431
Benton/Franklin Private Industry Council		
77% Adult Program (Original funding source: CTED)	Federal only	186,898
Wapato School District		
Migrant Project for Secondary Students	Federal only	\$66,848
Advocacy Project (Original Funding Source, Both Projects: OSPI)	Federal only	36,044
Total		102,892
Yakima Valley Community College		
Displaced Homemakers	State only	15,398
United Way		
Adult Literacy	Private only	<u>9,501</u>
TOTAL OTHER SOURCES		<u>\$566,120</u>
TOTAL ALL FUNDING SOURCES		<u>\$20,259,173</u>

Description of the Blended Resources Program

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

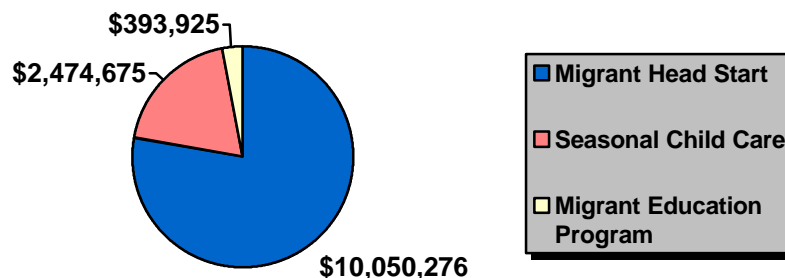
PROGRAMS AND AGENCIES

The Washington State Migrant Council (the Council) combines resources from three programs sponsored by the following federal and state agencies.

<u>Program</u>	<u>Agency</u>
Migrant Head Start (MHS)	U.S. Department of Health and Human Services (HHS)
Seasonal Child Care (SCC)	Department of Social and Health Services (DSHS)
Migrant Education Program (MEP)	Office of the Superintendent of Public Instruction (OSPI)

This chart depicts the revenues received by the Council from these three funding sources for the fiscal year ended October 31, 1997:

**Total Revenue For Blended Resources Program
Fiscal Year 1997**



Total \$12,918,876

BLENDING RESOURCES PROGRAM

The Council has developed a method of combining resources received from three federal and state agencies to operate a single program. This program delivers services to basically the same population of children from both migrant and seasonal farm worker families during the same period of time.

Grant agreements and contracts describe the three programs where the Council combines resources into a single program to provide services at its Child Development Centers as follows:

- The MHS program serves as the core of all services rendered to children at the Council. This grant helps children develop social skills and provides eight hours

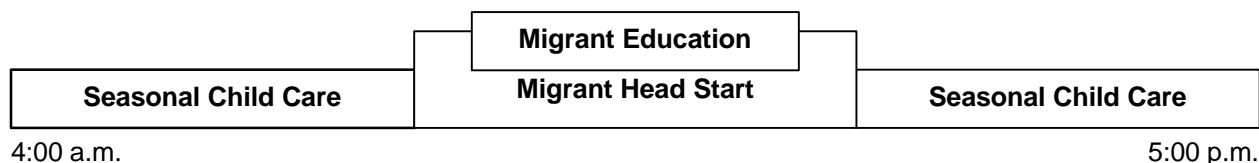
of Head Start. However, the Council had insufficient MHS funds to keep its Child Development Centers open for longer hours to meet the needs of parents working in the agricultural harvests.

- The SCC program provides for custodial care and the health and safety of children. The Council receives a fee-for-service from DSHS, and DSHS has classified the Council as a vendor agency for this program.
- MEP enhances the educational experience of children by supplementing instruction and extending the length of the day for up to 4 hours to meet the needs of parents working in the agricultural harvests. The Council is a subrecipient agency for the purposes of this grant.

However, the Council describes and operates these programs as follows:

- The Council believes that socially competent children will be more apt to learn. Thus, all children from migrant and seasonal farm worker families participating in programs at the Child Development Centers receive a program of education consistent with Head Start.
- Head Start is not required for children in the SCC program; however, the Council provides this enhanced level of service in addition to the required custodial care. According to the Council's MHS grant application, it uses the SCC program to extend the hours of operation of the Child Development Centers beyond that provided by Head Start.
- Since kindergarten-readiness is not a goal for children in the MHS or SCC programs, the Council uses MEP for this purpose. The length of the day was not extended as required. However, the Council stated that it used MEP funds to lower instructional ratios.

This chart depicts the services delivered by the Council during a typical operating day:



By combining resources from the MHS, SCC and MEP grants, the Council believes it is able to provide extended day services to families and children at a reasonable cost.

HHS guidance indicates that Head Start programs are to be the payer of last resort when another program has primary responsibility for providing services to children. The

SCC program contract states that contractors shall not bill DSHS for costs paid or eligible to be paid by another funding source. Finally, the OSPI contract for MEP specifies that there can be no duplication of other programs or funds.

The Council believes all agencies providing funds for the blended resources program have indicated that they want to be the payer of last resort for services. Since the Council believes it is unable to operate under these restrictions, it has designated the MHS program as the grant primarily responsible for paying for the cost of services delivered at the Child Development Centers. The basis for this determination is that the MHS program:

- Is funded by a grant.
- Provides for start-up, preparation, planning and training.
- Requires comprehensive services for children.

EXPLANATION OF PROGRAMS

Migrant Head Start Program.

MHS focuses on the social and emotional development of children. There are no specific attendance requirements for children who participate in the program. MHS establishes minimum requirements for the education and early childhood development services provided to children ranging in ages zero through five. To be eligible, a family must have moved within the last two years in order to obtain employment in agriculture, and meet certain income guidelines. In addition, at least 51 percent of the previous 12-months income for the family must be from agricultural-related employment. HHS funding is provided in the form of a grant, with a commitment from the Council that it will provide the services outlined in the grant application.

MHS provides developmental pre-school activities for children from low-income families. However, it also assists parents in gaining parenting skills, provides parent involvement opportunities and assists in meeting the family's social service and health needs. All Head Start programs are required to meet rigorous national performance standards in all areas of service and are monitored accordingly.

The Council receives funding directly from HHS to provide child development services to eligible children of migrant workers in the state of Washington. This is the primary source of funding for the services provided to all children in the Council's Child Development Centers which operate a MHS program.

In fiscal year 1997 and in the immediate years prior to this date, the Council's grant application to HHS was based on providing services to 2,332 children. But, in recent years, the amount of children served in the program has declined. As a result of these changes, the Council's grant application was reduced to 2,111 children in fiscal year 1998, and then reduced again to 1,732 children in fiscal year 1999. In our opinion, the number of children in the grant application may need to be reduced to as low as 1,500 because attendance in the MHS program did not exceed this level in either fiscal years 1997 or 1998.

Seasonal Child Care Program.

The Council receives funding directly from DSHS to provide Seasonal Child Care services to the children of farm workers. Once a child is determined to be eligible, SCC services are authorized for specific amounts of time, i.e.; hourly, half day (less than six hours), or full day (six hours or more). The Council bills DSHS on a monthly basis for all children in attendance using the DSHS Social Service Payment System. Except for a limited number of absences, funding is provided only for the days when children actually attend the centers. Planning, preparation and start-up costs are not factored into the reimbursement methodology. SCC was developed as a service to agricultural families to make it possible for them to go to work. Unlike Head Start, child care programs are not required or funded to provide comprehensive services for nutrition, health, social services, parent development or the education of children. Funding levels for child care are set at a level that only assures the physical well being of children while the parent is absent.

Migrant Education Program.

MEP is based on the premise that children who are both poor and migratory are more likely to have difficulty in school. Migrant children need help to compensate for the effects their mobile lifestyle has on learning. There are no income guidelines for this program.

MEP funds were solely provided by the U.S. Department of Education and were passed-through OSPI to the Council. Services provided by the Council were billed directly to OSPI at the end of each month. The Council used MEP funds to facilitate and enhance the individual experience of pre-school children. These funds were used to lower instructional ratios, prepare children and parents for transition to the public school system, promote and strengthen language acquisition and introduce children to math, reading and writing. The program helps migrant children meet the academic demands of the early school years.

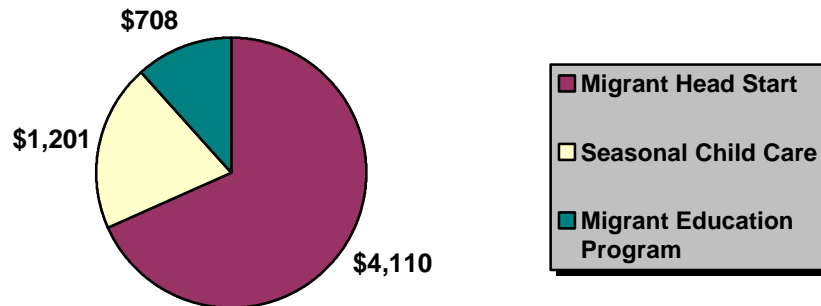
Average Cost Per Child Summary

The Council reported that the average cost per child for these programs for the fiscal year ended October 31, 1997, was as follows:

<u>Program</u>	<u>Average Cost Per Child</u>
Migrant Head Start	\$4,110
Seasonal Child Care	1,201
Migrant Education Program	<u>708</u>
Total	<u><u>\$6,019</u></u>

This chart shows the total cost per child for the Council's blended resources program for the fiscal year ended October 31, 1997.

**Total Cost Per Child For Blended Resources Program
Fiscal Year 1997**



Total \$6,019

Table 2, presenting a funding comparison for the Migrant Head Start Program, the Seasonal Child Care Program, and the Migrant Education Program, follows.

Audit Overview

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

AUDIT HISTORY

The Washington State Migrant Council (the Council) is a private non-profit organization that receives its annual audit from Moss Adams LLP, Certified Public Accountants. These audits are performed based on the requirements established by the Single Audit Act of 1984 (Public Law 98-502), the Single Audit Act Amendments of 1996 (Public Law 104-156) and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The Council is not subject to routine audits by the Washington State Auditor's Office. The Congressional Single Audit Act and state law do not require regular audits of state funds.

The Council's operations have been reviewed by a number of federal and state agencies over the past several years. Each agency has raised a number of concerns about the Council's activities. These concerns are summarized below to provide the reader with perspective about the events that led to this audit.

THE PUBLIC

In November 1997, the *Yakima Herald-Republic* published articles on the Council and the Enterprise for Progress in the Community, two private non-profit organizations in Sunnyside and Yakima, respectively. The newspaper asserted that these agencies were reaping the benefits of blended funding from state and federal programs by building up large surpluses over a period of several years. The newspaper's investigation caused a series of reviews of the Council by federal and state agencies. These examinations are described below.

THE COUNCIL'S CONTRACT AUDITOR

To meet the requirements of state and federal agencies, the Council has contracted with Moss Adams, LLP to be its auditor for at least 15 years. The auditor's annual reports on the Council's financial activities during this period have not generally included audit findings or questioned costs prior to fiscal year 1997.

The Council's single audit report for the fiscal year ended October 31, 1997, was issued on November 20, 1998. It indicated that the Council had almost \$14 million in assets. In addition, the audit report annually includes a qualified opinion on the Council's financial statements relating to the almost \$500,000 in assets originally received from Northwest Rural Opportunities when it dissolved in 1983. The basis for the qualified opinion is that land, buildings and equipment received prior to the Council's incorporation were recorded at the donor's cost. Additionally, no provision has been made for depreciation of the Council's buildings and equipment. As a result, land, buildings and equipment balances on the financial statements may be recorded at amounts in excess of that

required by generally accepted accounting principles. In the opinion of the Council's auditor, all donated property and equipment should have been recorded at its fair market value at the time of donation. Additionally, all capital assets should be depreciated over their useful lives to conform with generally accepted accounting principles. Finally, the Council's auditor could not reasonably determine the effect these accounting practices had on the Council's financial statements.

According to the terms of the Council's grant agreements and contracts, agencies have a reversionary interest and the first claim to a portion of the assets purchased by the Council. For the fiscal year ended October 31, 1997, the Council determined that the federal government and the state of Washington could claim approximately \$6.4 million and \$1.6 million, respectively, of the \$11.7 million in total buildings and equipment reported on the Council's balance sheet.

The Council's 1997 single audit report further discussed three areas of non-compliance with federal grant requirements:

- 1) Payroll. Migrant Head Start (MHS) administrative staff did not complete or maintain time and effort records to document payroll costs charged to federal grant programs (see finding number 4). Instead, the Council used letters of appointment and allocation change forms to establish the amount of payroll costs to be distributed to each grant program. All federal and state grants are affected by this condition. The report recommended that the Council obtain written approval from appropriate agencies for its method of allocating personnel costs, or establish the payroll system required by federal regulations.
- 2) Enrollment. The MHS program was under-enrolled during the current grant period (see finding number 7). The report acknowledges it is not always possible for the Council to reach enrollment levels due to the illness of children, weather conditions, crop failures and immigration concerns. Additionally, the fixed costs of delivering services to children actually enrolled make it necessary for the Council to incur certain expenses regardless of the level of enrollment. The report recommended the Council monitor enrollment levels on an on-going basis and make revisions in a timely manner, or, alternatively, obtain a waiver from the U.S. Department of Health and Human Services (HHS) for the reduced level of enrollment in the MHS program.
- 3) Matching contributions from other sources. The Council did not meet the almost \$1.2 million goal for matching contributions from other sources required by the MHS grant (see finding number 7). Grantees receiving MHS funds must obtain a certain amount of contributions from state, local and other sources in order to qualify for the level of funding specified in the grant. The Council has not been able to meet its matching contribution in the past; however, it requested and received a waiver from HHS for this requirement in prior years. A waiver was similarly requested from HHS for the current audit period because only two-thirds of the matching contribution had been obtained; however, the waiver had not been received as of the date of the Council's audit report. The report recommended that the Council monitor its matching contributions from other sources closely throughout the year, or, alternatively, request that

the amount be lowered in the grant award. If these two alternatives are not successful, then a waiver should be sought from HHS as soon as reasonably possible.

The Council's single audit report also contained a contingency note to the financial statements. It disclosed that federal and state agencies were reviewing or auditing the Council. These included, but were not limited to, the U. S. Department of Health and Human Services and the State of Washington's Department of Social and Health Services, Office of the Superintendent of Public Instruction and State Auditor's Office. It also stated that the outcome of these reviews and audits could not be predicted.

FEDERAL AND STATE AGENCIES

After the *Yakima Herald-Republic* articles about the Council's use of blended funding in November 1997, several monitoring reviews were conducted of the Migrant Head Start (MHS), Seasonal Child Care (SCC) and the Migrant Education Program (MEP) by federal and state agencies.

(1) Migrant Head Start.

The U.S. Department of Health and Human Services (HHS) has cited a number of problems at the Council in its monitoring reviews over the past few years. However, HHS and the Council have not been able to resolve some of these problems (see finding number 7).

HHS addressed a number of problems in the Council's MHS program in an October 3, 1996, monitoring report. The most significant issues were:

a. Nepotism.

Many family members related to key Council employees worked at the Council in violation of the federal Head Start Act. The report recommended the Council improve its policies and procedures for personnel hiring and record keeping. The Council had worked on a corrective action plan for a number of years.

On March 24, 1998, HHS followed-up on its prior reviews and asked the Council to identify the number of positions where nepotism actually existed.

The Council established a policy related to employing family members effective April 16, 1998. The purpose of this policy was to avoid potential conflicts of interest, nepotism, and other types of human relations issues that could occur as a result of employing family members at the Council. It states that no person will be employed by the Council if a member of his/her immediate family serves on the Board of Directors or one of the Policy Councils, or is already employed in any of the seven categories of key Council employees identified in the policy document. In addition, under no conditions would an employee be supervised directly or indirectly by an immediate family member.

In its April 14, 1998, response to HHS, the Council stated that five employees terminated employment with the Council on November 30, 1996, six employees were transferred from federal programs to non-federal programs on July 1, 1997,

and three employees are still employed in violation of the new nepotism policy. The Council requested that HHS approve the nepotism policy and the transfer of employees from federal programs to non-federal programs, as well as grant a waiver from the nepotism policy for the three employees identified above. Since HHS has not yet acted on the Council's request, this issue remains unresolved.

In a November 20, 1998, memorandum during our audit, the Council stated there has never been anyone related to the executive director on the Board of Directors. Only one prior Board member was related to an employee of the Council, and that member subsequently resigned.

b. Under-enrollment of children.

The Council had fewer children participating in the MHS program than specified in its grant agreement with HHS. The report recommended that aggressive on-going recruitment be continued throughout the year so that all eligible families in the Council's recruitment area would be identified and registered.

The MHS program continues to be under-enrolled. On March 24, 1998, HHS again commented on the under-enrollment in the MHS program and asked the Council to submit a revised budget. The Council reduced its enrollment estimates in fiscal years 1998 and 1999; however, actual attendance in fiscal years 1997 and 1998 indicates that these estimates may need to be reduced further. Each reduction in enrollment should result in a corresponding cut in the amount of funds HHS provides to the Council. This issue remains unresolved.

c. Cost allocation plan.

HHS stated that the Council needed to improve communication between financial, program and center staff members in the area of budgets, expenditures and matching contributions from other sources. Implementing the required cost allocation plan was also discussed in the report.

Since at least 1993, the Council has developed and implemented a cost allocation plan for its programs. However, the Council and HHS have never been able to agree on an acceptable plan.

In November 1997, HHS stated that the Council's July 1996 Agency Budget Implementation Plan was a step in the right direction, but indicated that more work was needed.

The Council has submitted many revisions of its proposed cost allocation plan to HHS. The latest version was prepared in April 1998 after an HHS representative visited the Council to assist in its development.

While OMB Circular A-133 requires that the cost allocation plan be approved by the funding source, HHS has never approved a plan for the Council. In addition, HHS has not yet responded to the Council's request to approve the April 1998 plan. During this audit, HHS informed us that the Council's most recent plan has not been approved because it is unacceptable. This issue remains unresolved.

On July 16, 1998, HHS reported that DSHS did not properly monitor the Council's unencumbered balances and unallowable expenditures in the SCC program.

a. Unencumbered balances.

While DSHS contracted with the Council as a vendor in a fee-for-service agreement, HHS believed the Council was a subrecipient for the funds it received from the Social Services Block Grant under Title XX of the Social Security Act (see finding number 6). The funds claimed by the Council exceeded actual expenditures and resulted in unencumbered balances. The Council treated these funds as earned income; however, a subrecipient cannot retain these funds under federal law. As a result, HHS requested that DSHS return these funds to the federal government. The Council claimed that it complied with its contract with DSHS and that the \$688,103 in funds it received represented earned income for the organization rather than a carry-over of unencumbered balances.

b. Unallowable expenditures.

The Council spent \$835,856 for leasehold improvements, construction and land during fiscal years 1995-97 (see finding number 6). The Social Security Act does not authorize these types of expenditures unless advance approval is obtained from the federal agency. Since advance approval was not obtained from HHS when the Council made these purchases, HHS requested that DSHS return these funds to the federal government. The Council was not aware that funds received from the SCC program were federal funds; thus, they did not obtain advance approval from the federal agency as required.

In a November 20, 1998, response to HHS, DSHS certified that only \$304,635 in block grant funds was used by DSHS to pay for Seasonal Child Care program services provided by the Council. However, our subsequent review of this calculation determined that \$541,557 actually should have been certified to HHS. DSHS agrees with our calculations and has notified HHS of this change.

In addition, DSHS does not concur with the central premise of the HHS finding. DSHS maintains that the Council is a vendor rather than a subrecipient for the block grant funds it paid to the Council for the SCC program, and is therefore not subject to federal regulations (see finding number 6). DSHS has asked HHS to clarify this issue, and understands that HHS has consulted with the U. S. Office of Management and Budget about the matter to ensure that similar activities are not questioned in the future. DSHS also understands that HHS will give DSHS an opportunity to appeal the decision prior to any action being taken to reduce the block grant award to the state of Washington. The results of these deliberations are not known as of the date of this report.

In its April 28, 1998, report, HHS stated that the Council's practice has been to provide Head Start for all children, migrant and seasonal, consistent with Head Start performance standards. The Council used excess revenues from its programs to fund the increased costs of providing these services to seasonal children. In addition, the overall result of these practices has been the generation of excess revenues over several years. The Council attributes these excess revenues to good management practices (see finding number 6). HHS concluded that the excess revenues were, in all

probability, federal funds that should have been reported as carry-over balances. In addition, program costs were not properly segregated.

In December 1997, HHS restricted the Council's MHS program funding for fiscal year 1998 to a quarterly basis rather than the customary annual basis. At the beginning of the fourth quarter of the grant, HHS further restricted funds on the Council's MHS grant by requiring it to budget operations on a monthly basis. During our audit, HHS approved fiscal year 1999 funding for the Council's MHS program.

During this audit, representatives from HHS were also reviewing the operation of the Council's Migrant Head Start and Region X Head Start Programs. The result of this audit is not known at the time of this report.

(2) Seasonal Child Care.

On November 19, 1997, the Secretary of the state of Washington Department of Social and Health Services (DSHS) reported to the Office of the Governor that an internal review of the Social Service Payment System (SSPS) had been conducted. The Secretary stated that SSPS management reports showed that the Council's billing practices were consistent with DSHS policies. In addition, problems such as duplicate billings, school-age children billed at full-day rates and maximum billings for part-month authorizations had not been observed.

On March 26, 1998, DSHS reported it was overcharged because the Council did not adjust authorized payment rates appropriately as children aged. As a result, DSHS questioned approximately \$32,000 in costs during the period January 1, 1996, through December 31, 1997. These same conditions were noted during this audit because we examined Council records from the same period of time. However, since the Council repaid these questioned costs by July 31, 1998, this issue is not discussed further in this report.

(3) Migrant Education Program.

On November 16, 1998, the state of Washington Office of the Superintendent of Public Instruction (OSPI) discussed three major findings in their report on the Council:

- The Council used average daily attendance counts for funding purposes, rather than counting only eligible children.
- The Council inadvertently used an inappropriate salary distribution system for payroll expenses charged to the MEP.
- Payroll costs for the Council's MEP were not supported by appropriate time records. This condition was indirectly caused by OSPI when it approved a salary distribution system for the Council that was not allowed by OMB Circular A-122, *Cost Principles for Non-Profit Organizations*.

As a result of these conditions, OSPI questioned approximately \$2.2 million in costs, or about 90 percent of the funds it had provided to the Council during the five-year period from July 1, 1993, through June 30, 1998.

The Council disputes the findings in this report and is currently corresponding with OSPI to resolve the matter. In addition, the Council has determined that it will not use MEP funds in fiscal year 1999.

WASHINGTON STATE LEGISLATURE

Washington State Representative James A. Clements, Chair of the House Select Committee on Vendor Contracting (the Committee), also received inquiries from constituents regarding the Council's activities. The Committee was formed in January 1996 as a result of numerous concerns about potential fraud, waste and abuse in private non-profit agencies. The goal of the seven-member Committee was to determine whether the state had established appropriate business processes to promote accountability for the handling of public funds by non-governmental entities delivering services for the state.

The Washington State Legislature first authorized the State Auditor's Office to perform audits of certain non-profit organizations in 1997. In 1998, it specifically requested that we audit the Washington State Migrant Council to review the blended resources program issue and determine whether improvements could be made in the manner in which public funds were administered by state agencies and the Council.

WASHINGTON STATE AUDITOR'S OFFICE

This is our first audit of the Washington State Migrant Council. It was performed pursuant to Chapter 232, Washington Laws 1998, *Audits of Nongovernmental Entities With State Contracts*, under the authority of Chapters 43.88 and 43.09, *Revised Code of Washington*.

In the past, each federal and state agency has exclusively examined only the programs it funds at the Council. In addition, the Council's auditor has similarly reviewed each of the Council's major programs separately. This audit takes a unique look at the federal and state grant programs where the Council combined resources to deliver services to children of migrant and seasonal farm worker families. This perspective is required to understand the relationships of these grant programs and the way the Council administers them.

CONCLUSIONS

Our extensive audit tests of the Council's disbursements during fiscal year 1997 found no fraud, misconduct or malfeasance.

Our brief review of operations at the Child Development Centers found that the Council appeared to provide quality child care services to migrant and seasonal farm worker families.

This report includes eight audit findings. These findings are briefly explained in the Audit Summary section of this report, and then presented in detail in the accompanying Schedule of Audit Findings.

- The primary purpose of this report is to assist the Council in improving financial reporting and in complying with federal and state laws and regulations and its own policies and procedures.
- A related purpose of this report is to assist federal and state agencies in improving collaboration, subrecipient monitoring, and the laws and regulations covering audits of organizations such as the Council.

Schedule of Audit Findings

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

1. **The Council received or was awarded at least \$6.7 million in excess funds from federal and state agencies for its blended resources program.**

Background

As presented in the Description of the Blended Resources Program section of this report, the Council combined resources from three federal and state agencies to deliver services as a single program at its Child Development Centers. Disbursements in these programs during the fiscal year ended October 31, 1997, were as follows:

<u>Program</u>	<u>Agency</u>	<u>Disbursements</u>
Migrant Head Start (MHS)	U.S. Dept. of Health and Human Services (HHS)	\$ 9,973,484
Seasonal Child Care (SCC)	Dept. of Social and Health Services (DSHS)	2,968,441
Migrant Education Program	Office of the Superintendent of Public (MEP) Instruction (OSPI)	<u>393,414</u>
Total		\$ <u>13,335,339</u>

Sources of funds provided to the Council were:

- HHS provided federal funds directly to the Council for the MHS program. No state funds were involved.
- MEP funds were solely provided by the U.S. Department of Education and were passed-through OSPI to the Council. No state funds were involved.
- The SCC program received 42 percent of its funds from DSHS and 58 percent of its funds from HHS. The HHS funds passed through DSHS to the Council. Federal funds for the SCC program originated from the Social Services Block Grant under Title XX of the Social Security Act.

Description of Condition

A special focus of this audit dealt with the method the Council used to operate a blended resources program using funds from HHS, DSHS and OSPI. The Council received or was awarded at least \$6.7 million in excess funds from federal and state agencies for its blended resources program. The Council disputes this position.

- The Council received or was awarded at least \$3 million in excess funds during fiscal year 1997 because the number of children in the MHS program was below

the Council's estimates, and HHS did not revise the funding to reflect actual enrollment.

- The Council received at least \$1.5 million in excess funds for services in the Seasonal Child Care (SCC) program in fiscal year 1997. The Council's billings to DSHS did not report that the majority of the hours of service provided to children who qualified for the SCC and MHS programs already had been funded by HHS. DSHS maintains that any overpayment made to the Council for child care services would have been by HHS rather than DSHS. HHS Migrant Head Start program staff disagree with DSHS's position. Therefore, this issue remains unresolved.
- OSPI questioned approximately \$2.2 million in MEP costs at the Council during the five-year period from July 1, 1993, through June 30, 1998. OSPI reported that the Council used average daily attendance counts for funding purposes, rather than counting only eligible children, and used an inappropriate salary distribution system for payroll expenses charged to MEP. This condition was indirectly caused by OSPI when it inadvertently approved a salary distribution system for the Council that was not allowed by Office of Management and Budget (OMB) Circular A-122, *Cost Principles for Non-Profit Organizations*.

Cause of Condition

When the Council entered into grant agreements with federal and state agencies, it accepted the responsibility for complying with the provisions of the contracts and agreements as well as with the required standards for financial management systems.

The Council believed its method of operating the blended resources program was properly disclosed to HHS and OSPI through its grant applications for MHS and MEP, respectively. However, the Council's contract with DSHS did not make such a disclosure.

In our opinion, agencies and the Council maintained different interpretations of the contracts, agreements, Code of Federal Regulations and other federal guidance for the three funding sources included in the blended resources program. Thus, communications about program requirements and expectations were often misunderstood and deficiencies were not always corrected in a timely manner.

Each federal and state agency focused primarily on its own program when performing reviews at the Council and may not have had a complete picture of how the Council managed its blended resources program. Thus, these agencies initially did not effectively communicate with each other and the Council to ensure success in accounting for and administering grant funds used in the Council's blended resources program.

Action was taken to remedy this condition when HHS, DSHS and OSPI began joint reviews and audits of the Council's blended resources program in 1997. However, additional work is needed. Since OSPI's MEP funds have not been used at the Council in program year 1999, the remaining agencies providing funds for the Council's current blended resources program, HHS and DSHS, need to collaborate with the Council to resolve the issues discussed throughout this report.

Specifically, DSHS stated that it relied upon the following criteria regarding the payer of last resort issue at the Council.

- The Code of Federal Regulations (CFR), Title 45, Subpart C, Head Start program options. Specifically, Section 1306.30, Provisions of comprehensive child development services, and Section 1306.32, Center-based program option.
- HHS Administration on Children, Youth and Families Information Memorandum Log No. ACYF-IM-HS-95-27, dated July 24, 1995.

The CFR discusses securing and using community resources and funds from other agencies, while the Information Memorandum discusses determining which agency is the payer of last resort when another funding source has primary responsibility for providing a service.

In our opinion, the MHS program has the primary responsibility for the comprehensive child development services provided by the Council. The MHS program is fully funded by HHS and provides the delivery of comprehensive health, educational, nutritional, social, and other services to economically disadvantaged children and their families. Grantees operating center-based Head Start program options, such as the Council, must employ two trained and qualified staff persons (a teacher and a teacher aide or two teachers) for each class. Whenever possible, there should also be a volunteer in the classroom. The Council appropriately stated in its grant application to HHS that child care services from the SCC program would be used to extend the hours of service beyond the basic eight hours of the MHS program at the centers. We believe this was appropriate because child care services are not needed during the MHS program day. Therefore, we believe the state of Washington should not be funding the provision of child care during the eight hours of the MHS program pursuant to the Head Start Act (Public Law 97-35).

This issue remains unresolved. Therefore, we believe DSHS and HHS must work together to resolve this complex issue.

Effect of Condition

Problems noted during our audit of the Migrant Head Start program, Seasonal Child Care program, and Migrant Education Program are described further below:

a. Migrant Head Start Program

The primary focus of this program is preparing children to enter school. Head Start provides comprehensive child development services, including classroom or group socialization activities designed to foster a child's social competence. It includes child health, safety, nutrition and mental health. HHS provides funding for only an eight-hour day. The Council stated that the funding provided by HHS is insufficient to maintain operation of its centers for longer hours to meet the needs of parents working in the agricultural harvests.

HHS considers estimated enrollment when establishing the amount of a grant and expects a grantee to notify it promptly if the actual number of children enrolled varies significantly from the original estimate. When HHS receives such a notification, it reevaluates the proposal to determine the amount by which the grant award needs to be

revised. The Council notified HHS of its enrollment and attendance information at the centers each month during program year 1997, as required. While the MHS program was under-enrolled, HHS did not reduce the Council's grant award. The Council requested and received three budget increases from HHS during fiscal year 1997. Additional MHS program costs were cited as the reason for these changes.

The Council continued to receive payments throughout the fiscal year based on the full amount of the original grant award. As a result, the Council received excess funds from HHS each year because there were fewer children participating in the MHS program than specified in the grant agreement.

The MHS program's estimated enrollment and actual attendance information for the past three program years is presented in the following table, which demonstrates that the Council's grant proposals after program year 1997 actually reduced estimated enrollment.

Council's Program Year	Grant Estimated Enrollment	Actual Highest Attendance
1997	2,332	1,485
1998	2,111	1,477
1999	1,732	-----

During a 1998 examination, HHS found that the actual number of children enrolled in the Council's MHS program for fiscal year 1997 never exceeded 1,598. Since HHS funded the Council for an estimated enrollment of 2,332 children for this period, it did not properly evaluate the effect this reduced enrollment would have on the total grant award to the Council (see finding number 7). Based on the under-enrollment of children in the MHS program, the Council received at least \$3 million in excess funds from HHS during fiscal year 1997.

The information presented above shows the highest level of attendance in the MHS program for program years 1997 and 1998. Actual attendance records for each complete year are included as Tables 3 and 4 at the end of finding number 1. These tables demonstrate that the under-enrollment condition could be significantly greater than presented above because attendance at the Council's Child Development Centers is significantly lower during most of the program year. The Executive Director describes MHS program enrollment and attendance as a bell curve throughout the program year. Under this scenario, the number of children participating in the MHS program begins low, increases steadily, reaches the highest point, decreases steadily, and then ends low.

b. Seasonal Child Care Program

The primary focus of this program is custodial care and the health and safety of children. SCC was developed as a service to agricultural families to make it possible for them to go to work. Unlike Head Start, child care programs are not required to or funded to provide comprehensive services for nutrition, health, social services, parent development or the education of children. Funding levels for child care are set at a level that only assures the physical well being of children while the parent is absent. DSHS defines a full-day as six or more hours of service.

DSHS can, in most instances, legitimately set up automatic full-day or half-day payment rates for eligible children in the SCC program. However, according to the Council's MHS grant application, the SCC program is designed to extend the hours of the Child Development Centers from eight hours to as many as 14 hours to meet the needs of parents working in the agricultural harvests. The implementation of full-day rates for the Council did not appropriately take into consideration those children who were dual enrolled and thus were already funded for eight hours of care in the MHS program.

The Council received excess funds from DSHS for child care services for children who were eligible for both the MHS and SCC programs. When dual-qualified children attended the Child Development Centers all day, the Council received payment for eight hours of service from HHS because the child participated in the MHS program. The Council also billed DSHS for the child's participation in the SCC program, indicating that full-day services (six or more hours) had been delivered to the same child during the same period of time. This billing did not factor in a credit for the amount of time the child already had participated in the MHS program. Thus, if a dual-qualified child was present at a Child Development Center for 10 hours, the Council was paid by two different agencies for delivering services to the child for at least 14 hours of care.

If the MHS program hours had been appropriately recognized on SCC program billings, the Council would only have been entitled to reimbursement from DSHS for providing services at the hourly rate for those hours beyond the eight hours of service the child was in the MHS program. The Council received excess funds in the SCC program because its bills to DSHS did not report that the majority of the hours of service provided to dual-qualified children each day already had been funded by HHS.

During this audit, we tested all child attendance records at the Toppenish Child Development Center for the seven months the MHS and SCC programs were operated in fiscal year 1997 (April-October). We noted only three occasions during program year 1997 when a child received child care services at the center for more than 12 hours per day.

To determine the amount of reimbursement the Council should have obtained from DSHS for operating the Toppenish Center, we first determined how many hours every dual-qualified child was in attendance at the Child Development Center each day. We then deducted eight hours for the MHS program, giving us the number of additional hours which should have been billed to DSHS for the extended hours of child care provided in the SCC program. We then multiplied these additional hours by the hourly rate the Council should have been paid by DSHS to determine the total allowable charges. Finally, we compared allowable charges to actual payments to determine the amount of excess funds the Council received from DSHS. The Council's MHS grant application includes funding for bus transportation to and from its Child Development Centers. We have not included bus transportation in the computations shown in this finding because a specific period of time was not described for this activity in the Council's grant agreement.

Our audit test revealed that the Council received excess funds for providing services to children who were dual-qualified for both the MHS and SCC programs. For fiscal year 1997, we found that the Council received at least \$48,083 in excess funds from DSHS for operating the SCC program at the Toppenish Child Development Center. That is

55.3 percent of the \$86,932 billed to DSHS for this center during this period. DSHS disputes this position.

While we did not test child attendance records at any of the other Child Development Centers, it was the Council's policy to charge DSHS the full-day rate for every dual-qualified child present at all centers. Thus, while we cannot project the error rate for overcharges at the Toppenish Child Development Center to all payments the Council received from DSHS for all centers during fiscal year 1997, it would be reasonable to expect that similar tests at the other centers would yield similar results. Applying an estimated error rate of at least 50 percent for all centers to the total funds the Council received in fiscal year 1997, the Council received at least \$1.5 million in excess funds from DSHS, or twice the amount it should have actually received. We also noted that this condition continued at the Council during fiscal year 1998. DSHS also disputes this position.

The Council used some of these excess funds to purchase land, equipment and buildings (see finding number 6).

The Council also used some of these excess funds to subsidize families who, because of income levels, were expected to contribute at least small co-payments for child care provided to them in the SCC program. The Council chose to absorb the co-payments rather than to collect them.

c. Migrant Education Program

The primary focus of this program is the instruction of children. According to the OSPI contract, MEP is designed to supplement the education of children and extend the day for up to four hours for a minimum number of days per year to meet the needs of parents working in the agricultural harvests.

In its 1998 audit of MEP, OSPI questioned approximately \$2.2 million in costs during the five-year period from July 1, 1993, through June 30, 1998. The disallowed amount represented approximately 90 percent of the funds OSPI paid to the Council during the five-year period.

According to the contract, the Council was required to provide MEP services for a certain number of days at each Child Development Center. In its 1998 audit of MEP, OSPI found that some centers were not open at all or were not open for the number of days required by the contract. However, the Council maintains that it did not bill OSPI for any services not provided.

The OSPI audit report also stated that the Council routinely billed MEP for four hours of educational activities for all eligible children of migrant farm worker families. However, the Council was unable to demonstrate how these instructional services differed from services already provided to the children in the MHS program.

The grant agreement provides that the Council may be paid for up to four hours of instructional services when it complies with all of the provisions of the contract. Since these activities occurred during the same time the Council delivered services to many children who were already dual-qualified for the MHS and SCC programs, the instruction did not occur in an extended day environment as required by the contract.

As indicated above, when dual-qualified children received full-day services at the Child Development Centers, the Council received payments from both HHS and DSHS for delivering full-day services to the same population of children during the same period of time. The Council then received payment from OSPI for delivering an additional four hours of instructional services during this same period of time, even though these activities were not supplemental and the day was not extended as required by the contract.

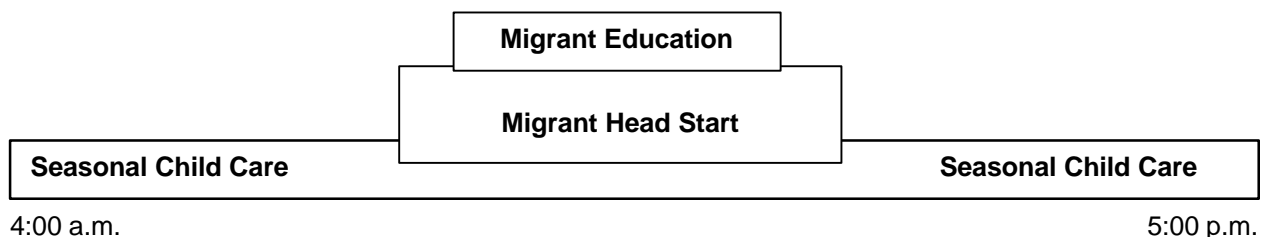
Since at least 1992, OSPI performed subrecipient monitoring for MEP and stated that it reviewed the Council's single audit reports. It periodically issued letter reports to the Council raising questions about the apparent dual-funding of children and reviewed the Council's response to these conditions. When the Council assured OSPI that proper corrective action had been taken in the areas cited, OSPI did not perform subsequent on-site reviews or tests of transactions and records to verify the information. Thus, OSPI accepted the Council's position without verification, even when subsequent monitoring reviews indicated that the same problems appeared to be continuing over a period of years.

In summary, the Council first received payment from HHS for providing full-day services to the children, or an eight-hour day as defined in the grant agreement. The Council then received payment from DSHS for providing full-day services to many of the same children, or six or more hours per day as defined in the contract. Finally, the Council received payment from OSPI for four hours per day for providing educational activities to many of the same children. Thus, if a triple-qualified child was present at a Child Development Center for 10 hours, the Council was paid by three different agencies for delivering services to the child for at least 18 or more hours of care. As a result, OSPI questioned approximately \$2.2 million in costs for MEP over a five-year period.

This condition could affect future federal and state funding to the Council.

This chart depicts the manner in which services were delivered by the Council during a typical operating day for the MHS, SCC and MEP grants.

Blended Resources Program as Depicted by this Audit



Recommendations

We recommend the Council:

- Comply with the provisions of its contracts and agreements as well as with the required standards for financial management systems.

We recommend HHS, DSHS and OSPI:

- Provide sufficient information to organizations such as the Council when grant agreements and contracts are awarded to ensure there is an overall understanding of expectations and program requirements.
- Coordinate the approval of contracts and agreements when entities intend to blend resources, and specify expectations for the handling of public funds.
- Work with the Council to resolve the excess funding received for MHS, SCC and MEP as outlined in this finding.

We recommend HHS and DSHS:

- Adequately monitor the Council's programs and financial activities, coordinate reviews and audits of MHS and SCC, and promptly resolve findings from reviews of the Council's programs.
- Jointly meet with the Council to:
 - ✓ Resolve the issues described in this finding and throughout this report.
 - ✓ Ensure a mutual understanding of the services to be delivered for the grants included in the blended resources program, determine an appropriate allocation of program costs to each grant, and establish the proper level of funding each agency should provide to the Council.
 - ✓ Determine whether a memorandum of understanding is needed to specify how operating costs of the Council's blended resources program will be shared by each agency.

We recommend OSPI:

- Enhance its current monitoring procedures by implementing follow-up steps to verify information provided by its grantees, when appropriate.
- Ensure that program staff are informed of the requirements of OMB Circular A-122, *Cost Principles for Non-Profit Organizations*.

Council's Response

WSMC strongly disagrees with this finding and asks that it be removed.

This finding consists of two parts. First, it states that WSMC received in excess funding \$3.0 million from Head Start and \$1.5 million from the Department of Social and Health

Services (DSHS). Second, it adopts without any critical analysis the findings of the Office of the Superintendent of Public Instruction (OSPI) concerning WSMC's Migrant Education Program.

As an initial matter, this finding demonstrates a complete lack of understanding of early childhood programs since an underlying premise of this finding must be that each program (Migrant Head Start or Title XX) provides sufficient funding by itself to provide comprehensive, high quality, full-day early childhood education services. This is a false premise since, as discussed below, without blending, funding levels would be appallingly low. A second premise of the report, that the funding sources must be used sequentially, i.e.; first six hours of Head Start, then six hours of Title XX and then four hours of MEP, is also equally false. There is no provision in any of WSMC's grants or contracts that prohibit parallel funding of different aspects of WSMC's overall early childhood education program.

Indeed, the Head Start program has issued at least three "Information Memorandums" that strongly encourage agencies like WSMC to blend funds in the manner that it has here. This has long been the policy of the Head Start Bureau which has encouraged Head Start programs to develop a variety of models of service delivery. These models have been referred to as the co-location model, the blended model, the before and after Head Start model, the resource and referral model, the wrap-around model, and the family day care model among others. In short, this "blending" is not something that WSMC simply created out of whole cloth but is an established practice across the country.

Moreover, we believe that a comparison of the cost per pupil in various school districts around the state with WSMC's program shows quite clearly that if \$4.5 million (the so called "excess funds") were eliminated, i.e., no blending, from WSMC's budget, WSMC would be unable to provide quality services. We believe blending of funding is crucial to the ability of any entity to provide high quality services that are responsive to the needs of children and families.

A good example of the potential impact of your office's recommendation is provided by comparing the cost-per-pupil figures from WSMC to various local school districts. As the report points out, WSMC's cost per pupil with all sources of funding blended is \$6,019. This cost is for nine or more hours of service per day. In contrast, the average cost per pupil in all school districts in the State of Washington is \$6,169; in Yakima, \$6,395; and, in Sunnyside, \$5,898. All of these figures are for seven, not nine plus, hours per day of services. They are also for an older (and therefore, less expensive) population. Most importantly, without blending and by actually implementing the findings of the audit from your office and from OSPI, migrant and seasonal children, instead of receiving an education and ancillary services comparable to other children in Washington, will receive significantly less services. In short, the implementation of the recommendations that your office and OSPI are making will mean that one of the neediest and most vulnerable populations in our State will, once again, be singled out for disparate and sub-standard treatment. Surely, this cannot be a policy that you or your office would want the State to implement. Moreover, these numbers clearly show that any single program, by itself, is inadequate to provide much needed services.

There is another equally significant point about the blended funding that your report obliquely addresses when it states that your office found "no fraud, misconduct or malfeasance". While many, but not all, of WSMC's children are eligible for all three

programs (Migrant Head Start, Title XX and MEP), no program paid for the same service that another program had paid for. This means quite simply that no cost was paid for more than once and that all of the funds went to pay necessary programmatic costs. WSMC would also note that it believes its use of funds from the sources covered by your report are no different than the use of the same or similar funds by virtually every school district in the State. This fact again raises the question of whether WSMC and the population that it serves is being singled out for disparate treatment.

With respect to more specific issues, your office's report contains a number of flaws. First, with respect to WSMC's Migrant Head Start program, it uses a figure -- 1598 -- for total enrollment during the 1997 growing season that is wholly incorrect. As the attached chart shows (Table 5), funded enrollment and actual enrollment were extremely close during most of the growing season with some under enrollment at the beginning of the year. In fact, peak enrollment was almost 2,000 children for 1997. Additionally, services to 773 children were extended into the month of October. Second, and equally significant, is the fact (a fact your report curiously fails to mention) that WSMC did not use all of its Migrant Head Start funds for 1997. WSMC had an unused fund balance for the year of over \$900,000. Thus, while WSMC had a slight under-enrollment for the year, it did not use approximately 10% of its available funds. In other words, in contrast to the implication of your finding, WSMC's expenditures closely tracked its enrollments. We disagree with the method your office used to calculate an over-expenditure of Head Start funds because under-enrollment, for many reasons, is not a sufficient basis to disallow costs.

Next, with respect to the alleged over-expenditure of Title XX funds, WSMC, of course, disagrees with the claims made in the report. First, the statement in the report that "the majority of the hours of service provided to dual-qualified children already had been funded by HHS" is, as discussed above, patently incorrect. None of the services paid for by Title XX had been paid for by Head Start. Second, WSMC clearly met its contractual obligations to the state and provided all of the services required. Finally, and most importantly, to the extent that WSMC achieved any surplus in any year with Title XX funds, WSMC spent those funds on facilities, equipment and services consistent with WSMC's mission to serve migrant and seasonal families.

With respect to the second part of this finding, relating to the OSPI audit, WSMC will not, on the advice of counsel, comment. Specifically, WSMC will not comment on any issues concerning or related to the disallowance of costs by the Office of the Superintendent of Public Instruction (OSPI) since, in a letter dated May 18, 1999, OSPI disallowed \$1.9 million in payments to WSMC over a five-year period (1993-1998) for the Migrant Education Program. WSMC does not believe that OSPI's decision is well founded in fact or law. Accordingly, WSMC will appeal the decision of OSPI shortly and expects that it will prevail. WSMC can only hope that your agency and the public allow it a fair opportunity to pursue its due process rights and not prejudge this issue.

In conclusion, while WSMC disputes the finding, we look forward to working closely with all the parties involved in this audit and to a positive and timely resolution of this audit.

HHS's Response

As you are probably aware, our office has worked in partnership with agencies in the State of Washington and the Washington State Auditor's Office, beginning with the Head Start child care joint review conducted in November of 1997. We have also worked very

closely with the Office of the Superintendent of Public Instruction and our Department's Office of Inspector General.

We are in agreement with all your findings except for finding number one (1). While in principle we agree on the importance of having open lines of communication between funding sources, we do not agree that the problems experienced by the Washington State Migrant Council had to do with lack of communication between funding sources. We believe that the problems revolved around weak or non-existent fiscal control systems, lack of grant oversight by the Washington State Migrant Council Board of Directors, and WSMC management's practice of making inappropriate journal entry adjustments. We also believe that the lack of clarity regarding WSMC's status as a recipient of Title XX funds contributed to the problem.

This office has provided the Washington State Migrant Council with sufficient funding, including indirect rate grant funds and direct grant funds, to appropriately administer the HHS-sponsored grant which specifically provided for comprehensive Head Start services -- not child care services -- for a period of eight hours per day. This level of funding allowed WSMC to design a program to provide quality Head Start services to children with an appropriate child-to-staff ratio during an eight hour period. WSMC's grant application, as funded by our agency, indicated that non-Head Start funds would be utilized to extend the day to twelve hours in order to meet the needs of migrant families.

There appears to be some misunderstanding on the part of the Department of Social and Health Services (DSHS) regarding our Information Memorandum dated July 24, 1995, especially the section which mentions that Head Start is a "payer of last resort". That memorandum provided general guidance to grantees to utilize good business practices and to avoid paying for services for which another agency has primary responsibility. It is not relevant to the current issue. The grant we funded for Head Start services, as described above, is the relevant document for this issue.

DSHS's Response

We absolutely agree that state and federal agencies must strengthen their working relationships when purchasing services from programs that pool resources to provide critical services to Washington residents. We are committed to making that happen and are working with the Federal Migrant Head Start Bureau to resolve these issues.

At issue in this finding is the determination of who has the authority to pursue recovery of an amount billed by the WSMC to the SCC and MHS programs for the same service.

The State Auditor's Office (SAO) has taken the position that DSHS is responsible for the over-payment of \$1.5 million as a result of being billed by WSMC for services already paid for by the Migrant Head Start (MHS) program.

In fact, DSHS made payment to WSMC for services provided to our clients under the Seasonal Child Care program in accordance with our contract and MHS made payment to WSMC for services provided under the MHS grant. The federal regulations indicate that any payments made for child care by the State should reduce the reimbursement that the WSMC receives under the federal MHS program. As such, any overpayment for excessive billings of child care services would be attributable to the MHS program and that program would have the authority to recover such overpayments.

We have provided SAO with the following references to support our position:

- 45 CFR 1306.30(d) - "All grantees must identify, secure and use community resources in the provision of services to Head Start children and their families prior to using Head Start funds for these services."
- 45 CFR 1306.32(d)(2) - "Programs are encouraged to meet the needs of Head Start families for full-day services by securing funds from other agencies."
- The HHS Administration on Children, Youth and Families Information Memorandum Log No. ACYF-IM-HS-95-27 -

"...it has always been our position that the Head Start program should be the payer of last resort..."

"Where services can be provided by referring children and families to other programs, then referral arrangements should be made. Where Head Start dollars are needed to provide the services but reimbursement is available, then reimbursement for as large a share of the costs as possible should be negotiated."

The Department of Social and Health Services interpretation of the above leads us to the position that the MHS has the responsibility and authority to recover any overpayments made to WSMC. We believe that the likelihood of collecting any overpayments from WSMC is improved under the interpretation of the federal rules, which we have cited above, thereby putting the taxpayers in the best position to receive amounts due.

However, if the Department of Health and Human Services (HHS) makes final determination that the above regulations do not apply to the MHS funds received by the WSMC, then DSHS will pursue recovery of any amounts determined to have been billed in excess of actual services provided. We will seek a prompt determination from HHS on the applicability of the federal regulations cited above.

OSPI's Response

As you are aware, the OSPI audit reviewed programs from the U.S. Department of Agriculture (USDA) and U.S. Department of Education (USDOE) which resulted in three findings:

- | | |
|-------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| USDA | (1) Inaccurate meal counts resulting in questioned costs of \$6,519; |
| USDOE | (2) Using average daily attendance of all children rather than only Title I Migrant children for funding purposes while not providing supplemental instruction, extended day, or the required number of contract days resulting in questioned costs of \$2.2 million; and, |
| | (3) Personnel time records did not adequately support payroll costs. |

Subsequent to the completion of OSPI's audit, Moss Adams, LLP, the Council's independent auditor, and the Washington State Auditor's Office have both audited the

Washington State Migrant Council and issued reports citing similar major findings. These findings relate to the Council receiving excess funds, lack of time and effort documentation and the unique issue of a blended resources program.

Based on the independent findings, this office agrees the Council received federal funds that they were not entitled to as a result of a failure to meet OSPI contract requirements. The Washington State Auditor's Office report captures the essence of the blended resources issues and addresses these contract requirements with the Council. OSPI plans to implement the recommendations outlined in the report.

Auditor's Concluding Remarks

We appreciate the responses to our recommendations that were received from the Council, HHS, DSHS and OSPI. However, we firmly believe the Council received or was awarded excess funds from federal and state agencies for its blended resources program. Therefore, we reaffirm our finding.

The conditions identified in this finding clearly point to the need for improved accountability over public funds when resources are blended to deliver services to the citizens of Washington. The lack of up-front federal and state agreement with the Council and guidance as to how the blended resources program was to be administered did not effectively support the Council. At the same time, the Council has a fundamental responsibility to be accountable for the public tax dollars it receives and spends.

We recommend the Council and federal and state agencies resolve the excess funding issues described in this report. We urge DSHS to pursue clarification of the payer of last resort issue with the federal government. We also recommend the Council's auditor follow-up on the recommendations contained in this finding during the next regularly scheduled audit to ensure compliance with applicable laws and regulations.

Beyond the resolution of the reportable conditions outlined in this finding, we urge the Council and federal and state agencies providing funding to the Council to reach agreement on the terms of any future blended resources program in advance of the delivery of services.

Applicable Laws and Regulations

The Office of Financial Management (OFM) *State of Washington Policies, Regulations, and Procedures* manual at 6.1.1., states, in part:

The agency director has the ultimate responsibility for establishing, maintaining and reviewing the system of internal control in the agency....Internal control systems include both internal accounting and administrative controls....Internal accounting controls are designed to provide reasonable assurance that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation....Administrative controls...ensure adherence to applicable laws, regulations, and policies....

The MHS grant award and all of the increases in effect during this time period designated a client population of 2,332. The original award also stated:

...The initial expenditure of funds by the grantee constitutes acceptance of this award.

The DSHS Standard Work Order for the applicable SCC contract states in Utility Code 209:

Duplication of Work: The contractor ensures that work to be performed does not duplicate work to be charged to the state of Washington under any other contract or agreement with the contractor.

The *Seasonal Child Care Guidebook*, which is incorporated into the SCC contract, states on pages 15–16:

Full-day care is authorized when a child needs 132 or more hours of care per month. A full day is six or more hours a day....

Half-day care is authorized when a child needs more than 65 hours of care a month, but fewer than 132 hours. A half-day is fewer than six hours a day....

Hourly care is authorized when a child needs 65 or fewer hours of child care in a month. The maximum number of authorized units for hourly care is 65 hours.

Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Subpart C, Section .300(b), provides additional guidance to auditees and states in-part:

The auditee shall maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

OMB Circular A-133, Subpart D, Section 400 (d), authorizes the OSPI audit and states that pass-through entities shall....

- (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

Attachment A, Section M, of the contract between OSPI and the Council also authorizes OSPI audits as follows:

...The...books, records, documents and other materials or evidence shall be maintained and made available by the contractor at all reasonable times for inspection, review, copying and audit by (1) persons authorized by [the] Superintendent....

Schedule of Audit Findings

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

2. The Board of Directors needs to improve its review of the Council's financial activities.

Background

The Board of Directors (the Board) primarily considers and acts upon matters which the executive director and administrative and program staff present to them for deliberation.

Our review of meeting minutes revealed that the Council presented certain financial information to the Board for review. This included information such as bids for purchases, grant budget proposals, the annual financial statements, land acquisitions, pension plan contributions, a salary study, lawsuits and a line of credit with a financial institution.

Description of Condition

Our review of meeting minutes revealed that the Board did not:

- Receive or review periodic financial reports on the Council's overall operations.
- Review transactions for the Council's unrestricted funds.
- Review and approve the Council's expenditures.

Cause of Condition

The Council's executive director did not provide all financial information to the Board for review and approval. In addition, the Board did not request this information to be provided to it.

Effect of Condition

The Board was not able to consider all financial activities of the Council during its deliberations.

Recommendation

We recommend the Board of Directors review all of the Council's financial activities.

Council's Response

WSMC requests that this finding be eliminated from the report. As an initial matter, the criteria listed in the draft audit report under applicable laws and regulations (45 CFR Section 1304.50), did not become effective until January 1, 1998, and is therefore inconsistent with the audit period. Second, WSMC believes that its Board has always reviewed a significant amount of information related to its finances. However, WSMC has re-designed the financial reports in the package of information that it provides to its Board in an attempt to address your concerns. To be clear, however, WSMC rejects any suggestion or implication that its Board is merely a "rubber stamp" for management.

Auditor's Concluding Remarks

We appreciate the Council's efforts to develop new financial reports to help the Board perform its oversight function. However, we reaffirm our finding. We reviewed the minutes of the Council's Board meetings during the period November 1, 1996, through May 31, 1998, during this audit. Therefore, the criteria we cited for this finding is appropriate. But, other similar financial and program management requirements also existed prior to January 1, 1998. These included the Code of Federal Regulations (CFR), Title 45, Part 74.21, Standards for Financial Management Systems; and the Head Start Act, Section 644, Administrative Requirements and Standards, and Section 647, Records and Audits. We recommend the Board effectively review the financial activities of the Council in the future. We further recommend the Council's auditor follow-up on the recommendation contained in this finding during the next regularly scheduled audit to ensure compliance with applicable laws and regulations.

Applicable Laws and Regulations

The Code of Federal Regulations, Title 45, sets forth the regulations for the use of grants and subgrants from the U.S. Department of Health and Human Services. Part 1304, Subpart D, identifies the governing body as the group with legal and fiscal responsibility and sets forth regulations for organizations such as the Council. Section 1304.50 states, in part:

.... (d) The Policy Council or Policy Committee. (1) Policy Councils and Policy Committees must work in partnership with key management staff and the governing body to develop, review, and approve or disapprove the following policies and procedures:....

(viii) The annual self-assessment of the grantee or delegate agency's progress in carrying out the programmatic and fiscal intent of its grant application, including planning or other actions that may result from the review of the annual audit and findings from the Federal monitoring review....

(g) Governing body responsibilities. (1) Grantee and delegate agencies must have written policies that define the roles and responsibilities of the governing body members and that inform them of the management procedure and functions necessary to implement a high quality program....

(2) Grantee and delegate agencies must ensure that appropriate internal controls are established and implemented to safeguard Federal funds in accordance with 45 CFR 1301.13....

Schedule of Audit Findings

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

3. **The Council used adjusting journal entries to transfer expenses from restricted grant programs to another grant program it believed was unrestricted.**

Background

The Council's *Policies and Procedures Manual* provides the basis for a strong system of internal controls. It is intended to ensure that expenses are charged to the appropriate federal or state program and are in compliance with all contract terms, conditions and budget limitations.

Description of Condition

When the cost of operating certain restricted grant programs exceeded approved annual budgets, the Council subsidized these programs by transferring certain expenses to a grant program it believed was unrestricted. Our review of these adjusting journal entries revealed that expenses were transferred from restricted grant programs primarily to the Seasonal Child Care program because the Council believed these funds could be used for any organizational purpose. The supporting documents for these transactions were not always readily available for review because they were often filed in the personnel department rather than in the accounting department. The Council stated that it ceased the practice of moving expenditures from one grant program to another on June 30, 1998. In our opinion, it was not cost effective or practical for us to determine the total effect of these adjustments.

Cause of Condition

The Council subsidized restricted grant programs with funds it believed could be used for any organizational purpose.

While the Council's computer could have been used differently, the accounting staff chose to process cash receipt transactions and transfers of fund balances at the end of grant program years by using adjusting journal entries. This practice significantly increased the number of adjusting journal entry transactions in the accounting system. These transactions should be the exception rather than the rule in any accounting system.

Effect of Condition

The Council's expenditures for each affected grant program are not accurate. To confirm the extent of the condition cited in this finding, we reviewed selected adjusting journal entry transactions in the months of November 1995; May and June 1996; and May, June and September 1997. Our review revealed transfers of expenditures for at

least eight grant programs totaling over \$118,000 during these test months. Thus, the expenditures reported on the Schedule of Expenditures of Federal Awards and Other Non-Federal Awards for the affected grants are inaccurate by at least this amount for fiscal years 1996 and 1997.

The Council's practice of using adjusting journal entries to transfer expenses between grant programs also increased the risk that unallowable costs might be charged to federal and state grants and not be detected in a timely manner (see finding number 6).

Recommendations

We recommend the Council:

- Comply with federal regulations, grant agreements and its own policies and procedures when allocating costs to specific grant programs.
- Record adjusting journal entries only for appropriate purposes.
- Properly justify all adjusting journal entries and retain supporting documents in the accounting department for review and audit.
- Transfer revenue from any unrestricted funds to the appropriate restricted grant program when approved annual budgets are exceeded in the future, if deemed necessary.
- Improve monitoring of program activities and amend operating budgets in a timely manner, if necessary.

Council's Response

WSMC would note that this finding addresses less than two percent of the total transactions that WSMC conducts during a year. Accordingly, we question whether it is even material. In any event, WSMC sees nothing wrong with using its unrestricted funds to effectively subsidize the government programs operated by WSMC and asks that the finding be removed.

Auditor's Concluding Remarks

We appreciate the Council's response to our recommendations. However, we reaffirm our finding. Office of Management and Budget Circular A-122, *Cost Principles for Non-Profit Organizations*, clearly states that costs may not be shifted from one program to another. In addition, an important purpose of the system of internal control is to ensure that expenses are charged to the proper grant program. Since the Council uses adjusting journal entry transactions to transfer costs from one program to another when costs exceed budgets, expenditure reports for the affected grant programs are not accurate.

While we are concerned about the actual amount of these adjustments, we are more concerned about the accounting practices used by the Council to accomplish its goals. Therefore, we recommend the Council refrain from this practice in the future. Otherwise, it will not be able to prepare accurate expenditure reports for each federal and state

program. If the Council continues to make adjusting journal entries in the manner described in this finding, its ability to obtain future funding from federal and state agencies could be jeopardized. We further recommend the Council's auditor follow-up on the recommendations contained in this finding during the next regularly scheduled audit to ensure compliance with applicable laws and regulations.

Applicable Laws and Regulations

OMB Circular A-122, Section A-4, Allocable Costs, provides guidance to grantees for allocable costs and transfers:

a. A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

- (1) Is incurred specifically for the award;
- (2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received; or,
- (3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

b. Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.

The Washington State Migrant Council Accounting Manual, Section 1, provides guidance to employees about the policies and procedures for allocable costs:

Costs must meet the "necessary and reasonable", "allowable", and "allocable" requirement based on OMB Circular A-122 and any applicable grant regulations before being charged to a grant. Any cost allocable to a particular grant may not be shifted to other Federal awards to overcome funding deficiencies.

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Subpart C, Section .300(b), provides additional guidance to auditees and states in-part:

The auditee shall maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

Schedule of Audit Findings

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

4. The Council needs to maintain appropriate time and effort records for payroll costs charged to federal and state grants.

Description of Condition

Council employees did not record the amount of time they actually worked on each federal and state grant on their time cards as required by federal regulations and state grant agreements. Instead, the Council used a substitute system to record employee time charges and distribute payroll costs to each grant. This alternative procedure was not approved by the U. S. Department of Health and Human Services (HHS). This condition affects the Council's payroll expenses for federal and state grants.

This condition was also included in the Council's single audit report for the fiscal year ended October 31, 1997, as well as in the Office of the Superintendent of Public Instruction's 1998 audit report on the Migrant Education Program. Both of these reports were issued during this audit. The Council's payroll system is summarized below.

When the Council hires an employee, the individual's payroll allocation for the various programs and work locations is documented on his/her letter of appointment. This payroll allocation is similarly documented on allocation change documents when the program or work location of an employee changes. Both of these documents are used for computer input and serve as the basis for distributing subsequent payroll costs to federal and state grants.

While some Child Development Centers used time clocks for employee attendance purposes, the primary source document used by the Council for payroll purposes is the employee time card. These time cards are completed by employees; approved by supervisors; summarized by department, work location, or center; and forwarded to the payroll coordinator for processing. However, these documents indicate only the total number of hours the employee worked each day during the pay period. The actual amount of time employees worked on each federal and state grant program is not shown. After all administrative time card verifications have been completed, the information for total hours worked is entered into the computer.

The computer processes the total number of hours the employee worked from the employee time cards, prepares the payroll checks for the employees and then distributes payroll costs to federal and state grants based upon the most recent payroll allocation information contained on the computer record for each employee.

As a result, actual payroll costs are distributed to federal and state grants in the same manner as depicted in agency budgets. Based upon these procedures, both budget and actual payroll costs will always be the same. However, budget estimates do not qualify as support for charges to grant awards.

Cause of Condition

The Council misinterpreted the federal requirements governing salary distribution when an employee's time is split between more than one program and at least one of them is a federally funded program. While not approved by HHS, the Council believed its alternative method of record keeping properly allocated payroll expenses to federal and state grants.

Effect of Condition

Since Council employees did not record the actual amount of time they worked on each federal and state grant on their time cards as required, no one is able to determine whether payroll costs are appropriately charged to these programs. This condition affects all Council employees whose payroll costs are allocated to more than one grant. By not complying with payroll requirements, the Council has not properly administered federal and state funds. This condition could affect future federal and state funding to the Council.

Recommendations

We recommend the Council:

- Develop an accounting system that demonstrates the actual amount of time spent working each day on federal and state grant programs on time cards, or obtain approval from agencies for an alternative method of time and attendance records for Council employees.
- Ensure that time and effort records are reasonably established and maintained for payroll costs directly charged to federal and state grants.

Council's Response

As is well documented, WSMC instituted a time and effort system approved by the State, specifically, OSPI. WSMC has now implemented a new system which is fully compliant with State and Federal regulations.

Auditor's Concluding Remarks

We appreciate the Council's response to our recommendations and its efforts to design new forms and implement new payroll procedures. These actions will help to ensure that future employee time and effort records are maintained accurately for all Council employees whose payroll costs are allocated to more than one grant program. We recommend the Council's auditor follow-up on the recommendations contained in this finding during the next regularly scheduled audit to ensure compliance with applicable laws and regulations.

Applicable Laws and Regulations

The Office of Management and Budget (OMB) Circular A-122, *Cost Principles for Non-Profit Organizations*, Attachment B, Paragraph 6.1, discusses the documentation

requirements relating to the time and effort of employees whose wages are charged to federal grants. It states in part:

Support of Salaries and Wages. (1) ... The distribution of salaries and wages to awards must be supported by personnel activity reports ... except when a substitute system has been approved in writing by the cognizant agency. (2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards ... Reports maintained by nonprofit organizations to satisfy these requirements must meet the following standards: (a) The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards. (b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization. (c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports. (d) The reports must be prepared at least monthly and must coincide with one or more pay periods....

An example of one state agency provision for the documentation requirements relating to the time and effort of employees is the Council's contract with the Office of the Superintendent of Public Instruction (OSPI). It states in part:

Non-Profit Organization shall require each of its employees and agents who perform services in fulfillment of this contract to maintain a daily written and signed log of the time spent performing these services and shall not include time spent performing any other service or activity.

The Contractor shall maintain current and accurate books, records, documents, and other materials that are relevant to the provisions of goods and services under this contract, and adequate to document, the nature and scope....

... The Contractor shall in addition maintain current and accurate books, records, documents, and other evidence, of procedures and practices, inclusive of employee/agent time and effort reports required by U.S. Department of Education....

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Subpart C, Section .300(b), provides additional guidance to auditees and states in-part:

The auditee shall maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

Schedule of Audit Findings

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

5. **The Department of Social and Health Services needs to ensure an adequate segregation of duties for the Council's determinations of eligibility, provision of child care services and authorization for payment in the Seasonal Child Care program.**

Background

The Department of Social and Health Services (DSHS) pays contractors for services performed under the Seasonal Child Care (SCC) program using the agency's Social Service Payment System (SSPS). Some contractors, including the Council, are authorized to enter this data directly into SSPS without verification by an independent party. All documents supporting these determinations are then required to be retained at the Council's offices.

Description of Condition

DSHS contracted with the Council to determine the eligibility of children of seasonal farm worker families for the SCC program, decide which organization would provide the services, deliver the actual child care services, and then authorize payments to themselves for performing the authorized services. This total control over the flow of funds from the SCC program did not provide an adequate separation of duties or appropriately safeguard tax dollars.

After confirming eligibility, the Council's program director entered the necessary data into SSPS to authorize child care services to be provided each month. The program director almost always authorized the full-day rate, which indicated the child was expected to be in attendance for six or more hours per day. When a child was also qualified to receive services from other programs, such as Migrant Head Start or the Migrant Education Program, the Council did not give a credit for the amount of time the child actually participated in these other programs (see finding number 1).

At the end of each month, SSPS automatically sent pre-printed invoices directly to the Council. These invoices indicated the amount of services authorized for each child. The program manager then entered the number of days each child was in attendance and the total amount of reimbursement requested, certified the invoice and returned it to DSHS. Reviews of the information submitted to DSHS were infrequent, if at all, and generally cursory in nature. Once DSHS employees input the Council's certified monthly information into the SSPS, payment was made. As a result, there was limited review or oversight by an independent party to determine whether all children were eligible to receive services and whether charges were reasonable and allowable.

Cause of Condition

Managers at DSHS believe many seasonal farm worker families feel more comfortable discussing eligibility issues with Council representatives rather than with social service workers. In addition, decreasing staff levels and increasing staff duties resulted in a DSHS decision which allows certain contractors to enter data directly into the SSPS. These staffing issues, coupled with the Council's control over supporting documents, precluded independent reviews and adequate monitoring by DSHS.

Effect of Condition

Because DSHS did not provide for review and oversight of the Council's billing practices by an independent party, the risk that errors and irregularities could occur and not be detected in a timely manner was significantly increased.

Recommendation

We recommend DSHS establish procedures that will achieve an adequate segregation of duties for eligibility determinations, provision of child care services and authorization for payments in the SCC program. This could occur in one of the following ways:

- Where practical, DSHS should segregate the activities of determining eligibility and providing child care between two contractors, with each serving as a check and balance for payment authorizations. These activities should also be periodically monitored by DSHS for compliance with SCC program criteria.
- Where such a division of duties is not possible, DSHS should increase monitoring activities to properly address the increased risk of errors and irregularities associated with contractor billings in the SCC program.

DSHS's Response

We agree that internal controls should be improved to ensure adequate segregation of duties.

As such, we have taken the following actions to strengthen internal controls over this program:

- *Through the issuance of a Request For Qualifications, we have selected and established new contracts with vendors to perform eligibility determinations. These vendors do not provide child care services for these clients and are not involved in the payment process for these services.*
- *As part of the new contracts, vendors performing eligibility determination are required to monitor the continuation of employment for 10 percent of the applicants they previously found eligible. Employment is one of the conditions of eligibility under the Seasonal Child Care Program.*
- *Established on-site monitoring requirements whereby DSHS staff review attendance records, determinations of eligibility, and other areas of compliance as prescribed within the contract.*

Auditor's Concluding Remarks

We commend DSHS for amending its contracting practices and monitoring activities. We will review the corrective actions taken during our next regularly scheduled audit of DSHS.

Applicable Laws and Regulations

The Code of Federal Regulations, Chapter 45, Part 74, establishes administrative requirements for the use of grants and subgrants from the Department of Health and Human Services. Subpart C, Section 74.21 (b) (3), states that a recipient's financial management system shall provide:

Effective control over and accountability for all funds, property and other assets. Recipients shall adequately safeguard all such assets and assure they are used solely for authorized purposes.

The Office of Financial Management (OFM) *State of Washington Policies, Regulations, and Procedures* manual at 6.1.1., states, in part:

The agency director has the ultimate responsibility for establishing, maintaining and reviewing the system of internal control in the agency....Internal control systems include both internal accounting and administrative controls....Internal accounting controls are designed to provide reasonable assurance that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation....Administrative controls...ensure adherence to applicable laws, regulations, and policies....

The OFM manual at 6.1.1.2.4.b. also states, in part:

Several basic internal control concepts underlie the characteristics of an internal control system for almost all types of assets. The following basic concepts are to be followed:

Division of Duties - Whenever possible, no individual is to have complete control over any type of asset in any agency, department, or division of the state....

The OFM manual at 6.1.1.2.1.b. also states, in part:

....A risk assessment of agency internal control systems is to be made annually. An internal control evaluation is to be made when the risk assessment indicates a high level of risk associated with an agency internal control system.

Schedule of Audit Findings

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

6. The Department of Social and Health Services (DSHS) needs to adequately monitor the Council's programs and financial activities.

Background

Many state agencies contract with or make subgrant awards and disburse state and federal program assistance to subrecipients. The federal government classifies a state agency acting as a grantor of federal funds as a pass-through entity. State government designates the agency as a primary recipient. Organizations receiving the grants are known as subrecipients.

Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a pass-through entity to monitor whether its subrecipients comply with applicable laws, regulations and grant provisions.

The Office of Financial Management (OFM) *State of Washington Policies, Regulations, and Procedures* manual contains policies intended to ensure state agencies comply with federal requirements regarding pass-through agents. OFM's fundamental policy is that state agencies have oversight responsibility for audits of subrecipients in the state of Washington.

Until it was revised in 1999, the manual described procedures for establishing cognizant state agencies and for monitoring subrecipients. OFM policies stated that, when more than one state agency provided federal assistance to the same subrecipient, the state agency providing the subrecipient with most of its federal funding could choose to assume the responsibility of the cognizant state agency.

If a state agency assumed the role of cognizant state agency, it was to notify other agencies providing federal funds to that subrecipient of its acceptance of these responsibilities. A cognizant state agency could be a federal agency that directly provided the majority of assistance to a subrecipient. In such cases, the federal agency would assume these responsibilities under a separate agreement with the state.

During the audit period, the cognizant state agency had the responsibility to ensure audits were completed under the federal Single Audit Act, if required, and to promptly inform other affected state agencies and the State Auditor's Office of any reported illegal acts or irregularities. The cognizant state agency was also required to coordinate the resolution of any audit findings that affected a program administered by another state agency. Finally, the cognizant state agency was to notify the Accounting and Fiscal Division of OFM of its assumption of cognizant state agency responsibilities.

According to OFM policy, a subrecipient had two responsibilities in this area. When it received federal assistance from more than one state agency, it was to ask the agency

that provides the majority of federal assistance to act as its cognizant state agency. In addition, if the subrecipient received most of its federal assistance from a source other than the state, it was to inform the cognizant state agency of the other source and ensure the organization providing most of the federal assistance was notified of the state agency's need for audit information.

The existence of a cognizant state agency does not relieve a pass-through entity of its federal responsibilities for monitoring subrecipients. The Single Audit Act requires pass-through entities to advise subrecipients of applicable federal laws and regulations, provisions of grant agreements and contracts, and any other requirements imposed by pass-through entities. Pass-through entities must monitor subrecipient compliance with these requirements and determine whether subrecipients have met Single Audit Act requirements. Pass-through entities also must ensure that subrecipients take appropriate and timely action regarding any audit findings and consider whether the audit results require any adjustments to pass-through entity records.

OFM policies included the above requirements and specifically required primary recipients to identify and pursue the resolution of questioned costs relating to the federal assistance passed-through to subrecipients. In addition, OFM required primary recipients to ensure that appropriate corrective action was taken within six months after the receipt of subrecipient audit reports containing instances of non-compliance with laws and regulations.

The Office of Financial Management (OFM) *State of Washington Policies, Regulations, and Procedures* manual defined the following terms at 4.3.8.1.2:

- Subrecipient – any person, governmental organization, or nonprofit organization that receives federal assistance from the state and wherein the state delegates some of the federal program policy and authorization responsibility.
- Vendor – a for profit organization or a not for profit organization that provides a state agency, recipient, or subrecipient with generally required goods or services that are related to the administrative support of the federal assistance program.

The Department of Social and Health Services (DSHS) is the primary recipient of U.S. Department of Health and Human Services (HHS) funds for the Social Services Block Grant under Title XX of the Social Security Act. DSHS combines federal and state funds in the SCC program. During the Council's fiscal year 1997, \$1,721,696 of the \$2,968,441 paid to the Council by DSHS was federal funding. The Council determines family eligibility and the types of services needed, and then provides the direct care to eligible children.

Description of Condition

We found the following conditions:

a. Cognizant agency.

No agency performed the cognizant agency role for the Council which is desirable, but not required.

DSHS could have designated itself as the cognizant agency and performed the related duties. However, DSHS did not do so.

While an appropriate alternative under these circumstances, the state of Washington did not enter into an agreement with HHS, the direct provider of \$10,050,276 in Migrant Head Start funds, to exercise the cognizant agency role on behalf of the state.

b. Subrecipient monitoring.

We believe the Council is a subrecipient of federal and state funds from DSHS in operating the SCC program. While solely providing child care services under a fee-for-service arrangement can be a vendor relationship, DSHS combined this activity with the responsibility of determining eligibility. DSHS did this because it believes many seasonal farm worker families feel more comfortable discussing eligibility issues with Council representatives rather than with social service workers. This added responsibility made the Council a subrecipient of SCC program funds. DSHS was, therefore, obligated to monitor the Council's eligibility determinations.

DSHS did not perform its own audits or reviews of the SCC program during the period April 1985 to November 1997. DSHS stated that it reviewed the Council's single audit reports; however, its primary monitoring activities during this period were related to day care licensing requirements rather than to the Council's program and financial activities. In addition, it did not consider the effect of the other grants used in the Council's blended resources program.

Cause of Condition

- DSHS believes the Council is a vendor rather than a subrecipient. DSHS stated that it made this determination in good faith following guidance in OMB Circular A-133.
- DSHS did not choose to assume the role of cognizant agency or perform subrecipient monitoring because it classified the Council as a vendor rather than as a subrecipient for SCC program funds.
- The OFM manual did not provide procedures for state agencies to follow when they monitor state or federal funds spent through contracts or grants with other organizations.
- Decreasing numbers of DSHS employees with increasing responsibilities resulted in a low priority being placed on monitoring activities beyond the review of the audit performed by the Council's auditor.
- OMB Circular A-133 does not adequately address the blending of resources from closely related programs that have dissimilar compliance requirements but are related in purpose (see finding number 8).

Effect of Condition

- a. Since there was no cognizant agency, no one gave overall program or fiscal guidance to the Council.
- b. Based upon the contract provisions for the SCC program and DSHS's position that the Council was a vendor rather than a subrecipient, we believe that DSHS did not properly monitor the Council's operations or hold it accountable for the use of the federal funds it received. In addition, DSHS may not have had a complete picture of the Council's blended resources program. As a result, the Council retained funds that were in excess of those actually needed to provide the hours of child care chargeable to the SCC program because it believed these unrestricted funds could be used for any organizational purpose.

As indicated below, the Council also used these funds for purposes that did not conform with the objectives of the Social Services Block Grant or other federal regulations.

As reported by HHS in a July 16, 1998, letter to DSHS, the Council spent \$835,856 of its perceived unrestricted SCC program funds for leasehold improvements, construction and land during fiscal years 1995-97. The required advance approval was not obtained from HHS because the Council was not aware that federal funds had been received from DSHS. Believing it was a vendor, the Council thought it was entitled to use any excess funds beyond those needed to provide services to children as it deemed appropriate. Thus, the Council appeared to have acted in good faith when it used federal funds to make these purchases.

The Council indicated that funds for these purchases came primarily from what it believed to be unrestricted funds from the SCC program. DSHS partially funds the SCC program with an HHS award from the Social Services Block Grant under Title XX of the Social Security Act. However, no one is able to determine the exact source of these excess funds because of the manner in which the Council has transferred expenses between grant programs (see finding number 3). In its report, HHS accepted the Council's statement that the funds came from the block grant.

In addition to the \$835,856 of unallowable expenditures described above, HHS also reported that the funds claimed by the Council and reimbursed by DSHS exceeded actual expenditures and resulted in unencumbered balances of \$688,103. The Council claimed that it complied with its contract with DSHS and that the funds it received represented earned income for the organization.

In a November 20, 1998, response to HHS, DSHS stated that, of the \$1.5 million in question, only \$304,635 in federal block grant money was used by DSHS to pay for the SCC program at the Council. DSHS provided the remainder of the money from state funds. However, our subsequent review of this calculation determined that \$541,557 was a more accurate amount for certification to HHS. DSHS agrees with our calculations and stated that it has notified HHS of this change.

In addition, DSHS does not concur with the central premise of the HHS finding. DSHS maintains that the Council is a vendor rather than a subrecipient for the

block grant funds it paid to the Council for the SCC program, and is therefore is not subject to federal regulations. In its July 16, 1998, letter to DSHS, HHS stated that the state of Washington, as the recipient of Social Services Block Grant (SSBG) funds, was responsible for the oversight of a subrecipient's (the Council's) expenditure of SSBG funds. DSHS has asked HHS to clarify this issue, and understands that HHS has consulted with the U. S. Office of Management and Budget about the matter to ensure that similar activities are not questioned in the future. DSHS also understands that HHS will give DSHS an opportunity to appeal the decision prior to any action being taken to reduce the block grant award to the state of Washington. The results of these deliberations are not known as of the date of this report.

This condition could affect future federal and state funding to the Council.

Recommendations

We recommend OFM:

- Consider reestablishing guidance related to the cognizant agency role.
- Develop a method to track organizations that receive funding from multiple state agencies and ensure that the agencies properly coordinate subrecipient monitoring.
- Establish monitoring guidance for state agencies that contract with non-governmental subrecipients to deliver services.
- Encourage state agencies to consider the effects of other programs on its monitoring procedures when organizations such as the Council blend resources from several agencies to deliver services.
- Ensure monitoring and audit report findings are satisfactorily resolved within six months.
- Provide training and guidance to non-governmental entities delivering grant and contract services.

We recommend DSHS:

- Coordinate with HHS to resolve the issue of whether contractors such as the Council are subrecipients or vendors, and then make changes to future contract award procedures, as deemed appropriate.

OFM's Response

Much of the State Auditor's recommended guidance already exists at the state and/or federal level. Existing guidance covers the responsibilities of the organizations spending federal funds, responsibilities for audit finding follow-up, responsibilities of the cognizant agency for audit, and requirements for monitoring subrecipients. In spite of these regulations, policies and guidelines, the situation at the Council occurred because implementation of guidelines broke down.

- *While the Council was required to be accountable for the federal funds it received, Council staff overrode existing internal controls when they processed adjusting journal entries to transfer certain expenses from restricted grant programs to other unrestricted programs.*
- *The Single Audit reports for the fifteen years prior to 1997 failed to report on the lack of operational internal controls. Because the audit reports were "clean", grantor agencies were not put on notice that there were organization-wide problems at the Council that could affect their programs.*
- *There was no review of the quality of the Single Audits of the Council.*
- *While state policy would have established the U.S. Department of Health and Human Services as the state cognizant agency, federal agencies are not bound by state policy, so this didn't happen.*
- *DSHS followed existing federal regulations and made a good faith determination that the Council was a vendor, not a subrecipient. Therefore, the requirements related to subrecipient monitoring were not deemed applicable.*

OFM recognizes that there is always room for improvement. Accordingly, OFM recommends the following approach to best address issues that led to the situation at the Council, including some improvements already underway:

- a. *Upon receipt of the draft report of this audit, we increased emphasis in training classes on the criteria for making subrecipient/vendor determinations, as well as monitoring responsibilities when an organization is determined to be a subrecipient. We will also look for opportunities to collaborate with other agencies on training opportunities related to monitoring issues.*
- b. *We continue to work with the Task Force on Agency Vendor Contracting that was established by the 1998 Legislature. The Task Force was created to study state social services contracting practices and make recommendations for improving management of fee-for-service and client-services contracts with nonprofit organizations providing social services. The Task Force is currently working with key legislators, state agency personnel, nonprofit organizations, and other interested parties to assess how the state can effectively and efficiently address situations where multiple state agencies provide funding to organizations such as the Council. The Task Force has a November 1, 1999, reporting deadline.*
- c. *In circumstances where a state agency is working with other state or federal agencies to fund delivery of services by contracting organizations, we will encourage state agencies to improve communications with other funding agencies. In doing so, state agencies can ensure funds go to pay for the services specified in agreements with the organizations.*

DSHS's Response

Although we do not concur with the basis for this finding, we have made changes to our contract language to clarify the vendor relationship and have also increased monitoring activities.

The primary basis for this finding hinges on the determination of the WSMC being a vendor or a subrecipient. We made a determination that this was a vendor contract for services, and therefore did not apply federal requirements that do not pertain to such contracts.

Although the State Auditor's Office agrees that DSHS established a vendor relationship with the Council for the provision of child care services, the auditor's office also believes that the Council was actually a subrecipient of federal funds from DSHS when we assigned the additional responsibility for eligibility determinations. In making this determination, SAO has made a retroactive application of federal requirements that would have applied had this been a subrecipient contract.

We feel that SAO's interpretation is inaccurate and that their retroactive application of federal requirements is inappropriate. In making its determination that this contract establishes a subrecipient relationship, SAO's only criteria is that the WSMC makes eligibility determinations. While the determination of eligibility is an indicator of a subrecipient relationship, other factors must also be considered.

The DSHS made the vendor determination in good faith under a reasonable interpretation of the contract as guided by the Office of Management and Budget Circular A-133. Some of the factors that support our determination that this contract was a vendor relationship and not a subrecipient are provided below:

- The SCC program was designed and developed by the DSHS, and the WSMC activity was limited to providing child care services.*
- Although the Council made eligibility determinations in the SCC program, it used very prescriptive DSHS requirements and had no authority to make changes to the criteria.*
- All amounts paid to the Council represented payments for child care services received and did not include any amount for eligibility determination activities. These payments were at rates established in the Washington Administrative Code and are the same rates paid for services to other licensed child care providers that do not perform eligibility determination activities.*
- The WSMC does not have responsibility for programmatic decision making and does not have its performance measured against whether the objectives of the Federal program are met. The DSHS clearly defined the requirements of services to be provided, and the WSMC received payment for these services in accordance with a fee schedule.*
- The services of the WSMC were competitively procured, the services are within their normal business operations, and similar services are provided to different purchasers.*

- *The OMB Circular A-133 recognizes that the determination of a subrecipient versus vendor relationship is a complex decision that requires the use of reasonable judgment.*
- *45 CFR 97.50(e) recognizes that under the block grant programs, the states are primarily responsible for interpreting the governing statutory provisions. As such, federal agencies will defer to a state's interpretation of its assurances and of the provisions of the block grant statutes unless the interpretation is clearly erroneous.*

The DSHS, in our monitoring of this fee-for-service contract, relied upon the results of the Single Audit that reported no deficiencies. In placing reliance upon the history of "clean" Single Audits performed by a contracted CPA firm, additional monitoring was not performed.

Additionally, there is no requirement for DSHS to assume the responsibility of a cognizant agency. Rather than one agency following the procedures required by the OFM, each agency independently performed these procedures as it pertained to their grant agreement or contract for services.

In an effort to resolve the issue of subrecipient versus vendor determination, we began working with the Department of Health and Human Services (HHS) in September 1998. The HHS has indicated that the determination is not clear and that they are seeking guidance from the Office of Management and Budget and will inform us of their determination. As of the date of this response, we have not received notification of HHS's decision. Should HHS not determine that this is a vendor relationship, we will appeal the decision to the HHS Department of Appeals Board.

Auditor's Concluding Remarks

We agree with OFM's comments on this finding and commend it for its current and planned improvements.

We also appreciate DSHS's response to our recommendation. However, we reaffirm our finding.

As discussed in its response to finding number 5, DSHS has amended its current contracting practices for the SCC program and increased its monitoring activities. The provision of child care is currently being properly contracted for under a fee-for-service vendor arrangement. Eligibility determinations are being performed under a separate contract with appropriate monitoring of this specific program requirement. We commend DSHS for taking this action.

We urge DSHS to pursue clarification of the subrecipient versus vendor issue with the federal government.

We will review DSHS's progress in this area during our next regularly scheduled audit.

Applicable Laws and Regulations

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, establishes standards for consistency and uniformity among federal agencies for the audits of states, local governments and non-profit organizations expending federal awards. Federal agencies are to apply the Circular's provisions to all recipients and subrecipients of federal awards.

- Subpart A, Section .105, defines a subrecipient as:

...a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program.
- Subpart B, Section .200, requires a non-federal entity expending \$300,000 or more in a year in Federal awards to have an audit in accordance with the provisions of the Circular.
- Subpart B, Section .210, lists the characteristics for subrecipient and vendor determinations as:

(a) General. An auditee may be a recipient, a subrecipient, and a vendor. Federal awards expended as a recipient or a subrecipient would be subject to audit under this part. The payments received for goods or services provided as a vendor would not be considered Federal awards. The guidance in paragraphs (b) and (c) of this section should be considered in determining whether payments constitute a Federal award or a payment for goods and services.

(b) Federal Award. Characteristics indicative of a Federal award received by a subrecipient are when the organization:

 - (1) Determines who is eligible to receive what Federal assistance;
 - (2) Has its performance measured against whether the objectives of the Federal program are met;
 - (3) Has responsibility for programmatic decision making;
 - (4) Has responsibility for adherence to applicable Federal program compliance requirements; and,
 - (5) Uses the Federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.

(c) Payment for goods and services. Characteristics indicative of a payment for goods and services received by a vendor are when the organization:

- (1) Provides the goods and services within normal business operations;

- (2) Provides similar goods or services to many different purchasers;
- (3) Operates in a competitive environment;
- (4) Provides goods or services that are ancillary to the operation of the Federal program; and,
- (5) Is not subject to compliance requirements of the Federal program.

(d) Use of judgment in making determination. There may be unusual circumstances or exceptions to the listed characteristics. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. It is not expected that all of the characteristics will be present and judgment should be used in determining whether an entity is a subrecipient or vendor.

- Subpart C, Section .300(b), provides additional guidance and states, in part, that the auditee shall:

Maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs.

- Subpart D, Section .400(c)(5), requires a federal awarding agency to issue a management decision on audit findings within six months after receipt of a report and ensure that the recipient takes appropriate and timely corrective action.
- Subpart D, Section .440(d), requires a pass-through entity to perform the following for its federal awards:

- (1) Identify Federal awards made by informing each subrecipient of Catalog of Federal Domestic Assistance title and number, award name and number, award year...and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.
- (2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.
- (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements...

- (4) Ensure that subrecipients expending \$300,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.
- (5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.
- (6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records....

The Code of Federal Regulations, Title 45, establishes administrative requirements for the use of grants and subgrants from the Department of Health and Human Services.

Subpart C, Section 74.21 (b) (3) states that a recipient's financial management system shall provide:

Effective control over, and accountability for, all funds, property and other assets. Recipients shall adequately safeguard all such assets and assure they are used solely for authorized purposes.

Subpart E, Section 96.50 (e) states:

The Department recognizes that under the block grant programs the States are primarily responsible for interpreting the governing statutory provisions. As a result, various States may reach different interpretations of the same statutory provisions. This circumstance is consistent with the intent of and statutory authority for the block grant programs. In resolving any issue raised by a complaint or a Federal audit the Department will defer to a State's interpretation of its assurances and of the provisions of the block grant statutes unless the interpretation is clearly erroneous. In any event, the Department will provide copies of complaints to the independent entity responsible for auditing the State's activities under the block grant program involved. Any determination by the Department that a State's interpretation is not clearly erroneous shall not preclude or otherwise prejudice the State auditor's consideration of the question.

The Social Security Act, 42 U.S.C. 1397(d), Title XX, Section 2005, provides limitations on the use of federal funds:

- (a) Except as provided in subsection (b), grants made under this title may not be used by the State, or by any other person with which the state makes arrangement to carry out the purposes of this title - (1) for the purchase or improvement of land, or the purchase, construction, or permanent improvement (other than minor remodeling) of any building or other facility.
- (b) The Secretary may waive the limitation contained in subsections (a) (1) and (4) upon the State's request for such waiver if he finds that the

request describes extraordinary circumstances to justify the waiver and that permitting the waiver will contribute to the State's ability to carry out the purposes of this title.

The Office of Management and Budget (OMB) Circular A-122, *Cost Principles for Non-Profit Organizations*, Attachment B, Paragraph 13, states that capital expenditures for land, buildings and general purpose equipment are unallowable except with the prior approval of the awarding agency.

The Office of Financial Management (OFM) developed the *State of Washington Policies, Regulations, and Procedures* manual to comply with the above requirements. It establishes the regulations and procedures for state agencies to administer federal pass-through programs and to monitor subrecipients.

- Section 4.3.8.1.5.a. defines a primary recipient as a state agency making subgrant or subcontract awards and disbursing its own program assistance as well as federal assistance to subrecipients. The section requires such a primary recipient to:
 - (1) Determine whether governmental subrecipients have met the audit requirements of ...Circular A-133.
 - (2) Determine whether the subrecipient has spent federal assistance in accordance with applicable laws and regulations.
 - (3) Identify questioned costs and other findings pertaining to the federal assistance passed through to subrecipients.
 - (4) Account for and pursue resolution of questioned costs.
 - (5) Ensure that appropriate corrective action is taken within six months after receipt of the subrecipient audit report on instances of material noncompliance with laws and regulations.
- Section 4.3.8.1.5.b. of the OFM manual states the following regarding cognizant state agencies:

When more than one state agency provides federal assistance to the same subrecipient, the state agency providing the subrecipient with the majority of federal funding can elect to assume the responsibilities of the "cognizant state agency" and is to notify other state agencies providing federal funds to that subrecipient of its acceptance of the cognizant state agency responsibilities. A cognizant state agency could be a federal agency in a case where they provided the majority assistance. In such cases, the federal agency under a separate agreement will assume cognizant state agency responsibilities....A cognizant state agency has the responsibility to:

- (1) Ensure that an appropriate single or program audit are made and received in a timely manner in accordance with the requirements of OMB Circular... A-133...

(2) Promptly inform other affected state agencies and the Office of the State Auditor of any reported illegal acts or irregularities.

(3) Oversee the resolution of audit findings that affect the programs of more than one state agency.

(4) Coordinate the resolution of any audit findings that affect a program administered by another state agency.

(5) Notify OFM, Accounting and Fiscal Services Division, of its acceptance of cognizant state agency responsibilities.

- Section 4.3.8.1.6.d. of the OFM manual states the following regarding subrecipients:

Subrecipients that receive federal assistance from more than one state agency should inform the state agency providing the majority of federal assistance of that fact and request that the state agency act as cognizant state agency for the subrecipient. A subrecipient with major federal assistance originating from a local or federal source (other than the state) should inform the cognizant state agency of the other source and ensure the organization providing the major federal assistance is notified of the state agency's need for audit information to comply with its own monitoring requirements.

- Section 6.1.1. of the OFM manual states the following about internal controls:

The agency director has the ultimate responsibility for establishing, maintaining and reviewing the system of internal control in the agency....Internal control systems include both internal accounting and administrative controls....Internal accounting controls are designed to provide reasonable assurance that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation....Administrative controls...ensure adherence to applicable laws, regulations, and policies....

- Section 6.1.1.2.4.b. of the OFM manual further states the following about internal controls:

Several basic internal control concepts underlie the characteristics of an internal control system for almost all types of assets. The following basic concepts are to be followed....

(2) Sound Policies and Procedures - Every effort is to be made to ensure that the assets of the state are properly handled. By supplying employees with strict control procedures and ensuring that they are followed through the use of checks and audits, the chance of losses will be greatly decreased.

The contract between DSHS and the Council states in section 703:

...The contractor shall obtain an annual independent audit as prescribed by Federal Office of Management and Budget Circular A-133 for non-profit organizations.

The Washington State Migrant Council Accounting Manual, Section 8, provides guidance to employees about the policies and procedures for equipment purchases:

All equipment requests are forwarded to the Procurement Officer to assure that all grant or contract regulations are met. Approved requests are input into the computer which prints the purchase order, which is forwarded to the Procurement Officer to sign, verifying its coding, accuracy, and that it meets all grant or contract regulations.

Schedule of Audit Findings

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

7. **The U.S. Department of Health and Human Services (HHS) did not promptly resolve findings from prior reviews of the Council's Migrant Head Start program.**

Description of Condition

HHS did not promptly resolve findings and other related management issues from prior reviews of the Council's Migrant Head Start (MHS) program. In an October 3, 1996, monitoring report, HHS discussed the following three problem areas that remain unresolved as of the date of this report.

a. Nepotism.

Many family members related to key Council employees worked at the Council in violation of the federal Head Start Act. The report recommended the Council improve its policies and procedures for personnel hiring and record keeping. The Council had worked on a corrective action plan for a number of years.

On March 24, 1998, HHS followed-up on its prior reviews and asked the Council to identify the number of positions where nepotism actually existed.

The Council established a policy relating to the employment of family members effective April 16, 1998. The purpose of this policy was to avoid potential conflicts of interest, nepotism, and other types of human relations issues that could occur as a result of employing family members at the Council. It states that no person will be employed by the Council if a member of his/her immediate family serves on the Board of Directors or one of the Policy Councils, or is already employed in any of the seven categories of key Council employees identified in the policy document. In addition, under no conditions would an employee be supervised directly or indirectly by an immediate family member.

In its April 14, 1998, response to HHS, the Council stated that five employees terminated employment with the Council on November 30, 1996, six employees were transferred from federal programs to non-federal programs on July 1, 1997, and three employees were still employed in violation of the new nepotism policy. These individuals are related to either the executive director or the Migrant Head Start director, both of whom are identified as key Council employee positions in the nepotism policy document. The Council requested that HHS approve the nepotism policy and the transfer of employees from federal programs to non-federal programs, as well as grant a waiver from the nepotism policy for the three employees identified above.

Since HHS has not yet acted on the Council's request, this issue remains unresolved.

b. Under-enrollment of children.

The Council had fewer children participating in the MHS program than specified in its grant agreement with HHS. The report recommended that aggressive on-going recruitment be continued throughout the year so that all eligible families throughout the Council's recruitment area would be identified and registered.

The MHS program continues to be under-enrolled. On March 24, 1998, HHS again commented on the under-enrollment in the MHS program and asked the Council to submit a revised budget. According to the fiscal year 1997 HHS grant application, the Council was to provide services to 2,332 children. However, HHS found that the actual number of children enrolled in the Council's MHS program for fiscal year 1997 never exceeded 1,598 children. The Council then reduced its enrollment estimate to 2,111 children in fiscal year 1998, but actual attendance in fiscal years 1997 and 1998 never exceeded 1,500 children. The Council again reduced its enrollment estimate to 1,732 children in fiscal year 1999. Each reduction in enrollment should result in a corresponding cut in the amount of funds HHS provides to the Council.

The Council's single audit report for the fiscal year ended October 31, 1997, also contained a finding on this subject. The November 20, 1998, report stated that the MHS program was under-enrolled during the current grant period. The report acknowledges that it is not always possible for the Council to reach enrollment levels due to the illness of children, weather conditions, crop failures and immigration concerns. Additionally, the fixed costs necessary to appropriately deliver the services to children actually enrolled makes it necessary for the Council to incur certain expenses, regardless of the level of enrollment. The report recommended the Council monitor enrollment levels on an on-going basis, and make revisions in a timely manner, or, alternatively, obtain a waiver from HHS for the reduced level of enrollment in the MHS program.

See finding number 1 for additional information regarding under-enrollment in the MHS program. This issue remains unresolved.

c. Cost allocation plan.

HHS stated that the Council needed to improve communication between financial, program and center staff members in the area of budgets, expenditures and matching contributions from other sources. Implementing the required cost allocation plan was also discussed in the report.

Since at least 1993, the Council has developed and implemented cost allocation plans for its programs. However, the Council and HHS have never been able to agree on an acceptable plan.

In November 1997, HHS stated that the Council's July 1996 Agency Budget Implementation Plan was a step in the right direction, but indicated that more work was needed.

The Council has submitted many revisions of its proposed cost allocation plan to HHS. The latest version was prepared in April 1998 after an HHS representative visited the Council to assist in its development.

While Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires that the cost allocation plan be approved by the funding source, HHS has never approved a plan for the Council. In addition, HHS has not yet responded to the Council's request to approve the April 1998 plan. During this audit, HHS Migrant Head Start program staff informed us that the Council's most recent plan has not been approved because it is unacceptable. This issue remains unresolved.

The Council's single audit report for the fiscal year ended October 31, 1997, contained a finding in the MHS program which has been a problem area for a number of years.

Matching contributions from other sources. The November 20, 1998, report stated that the Council did not meet the almost \$1.2 million goal for matching contributions from other sources required by the MHS grant. Grantees receiving MHS funds must obtain a certain amount of matching contributions from state, local and other sources in order to qualify for the level of funding specified in the grant. The Council has not been able to meet its matching contribution in the past; however, it requested and received a waiver from HHS for this requirement in prior years. A waiver was similarly requested from HHS for the current audit period because only two-thirds of the matching contribution had been obtained; however, the waiver had not yet been received as of the date of the Council's audit report. The report recommended that the Council monitor its matching contributions from other sources closely throughout the year, or, alternatively, request that the amount be lowered on the grant award. If these two alternatives are not successful, then a waiver should be sought from HHS as soon as reasonably possible.

In the past, the Council included SCC funds in its projection about how it planned to meet the matching contributions from other sources requirement for the MHS grant. However, the Council reported that it did not include these funds in the final computations it reported to HHS. Thus, this issue remains unresolved.

Cause of Condition

HHS and the Council have not been able to reach mutually agreeable solutions to the operational problems cited in prior reviews by HHS and the Council's auditor.

Effect of Condition

As a result of the conditions discussed above in this finding, allocation of the Council's costs to federal and state agency programs cannot be resolved with any certainty. Thus, future audits cannot be efficiently and effectively accomplished until an acceptable cost allocation plan is approved, and agreeable solutions are reached for other findings that remain unresolved.

Recommendation

We recommend the U.S. Department of Health and Human Services promptly resolve all findings contained in monitoring reviews and issue timely management decisions on all outstanding audit findings.

HHS's Response

We are in agreement with this finding.

Council's Response

WSMC has received a February 9, 1999, letter from HHS which approved our nepotism policy and procedures, employee transfers and employee waivers.

Auditor's Concluding Remarks

We appreciate the responses to our recommendation that were received from the Council and HHS, and commend their efforts to resolve the nepotism issues described in this report. However, we recommend the Council's auditor follow-up on the remaining unresolved issues contained in this finding during the next regularly scheduled audit to ensure that the Council is in compliance with applicable laws and regulations.

Applicable Laws and Regulations

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Appendix A. Subpart D - Federal Agencies and Pass-Through Entities, provides guidance to the oversight agency for audit and federal agencies for the prompt resolution of audit findings. It states:

OMB Circular A-133, Section .105, states in part:

....Oversight agency for audit means the Federal awarding agency that provides the predominant amount of direct funding to the recipient not assigned a cognizant agency for audit. (HHS is the oversight agency for audit for the Council.)

OMB Circular A-133, Section .400, states in part:

(b) Oversight agency for audit responsibilities. An auditee which does not have a designated (Federal) cognizant agency for audit will be under the general oversight of the Federal agency determined in accordance with Section .105. The oversight agency for audit:

(1) Shall provide technical advice to auditees and auditors as requested.

(2) May assume all or some of the responsibilities normally performed by a (Federal) cognizant agency for audit.

(c) Federal awarding agency responsibilities. The Federal awarding agency shall perform the following for the Federal awards it makes:

(2) Advise recipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements....

(4) Provide technical advice and counsel to auditees and auditors as requested.

(5) Issue a management decision on audit findings within six months after receipt of the audit report and ensure that the recipient takes appropriate and timely corrective action....

OMB Circular A-133, Section .405, states in part:

(a) General. The management decision shall clearly state whether or not the audit finding is sustained, the reasons for the decision, and the expected auditee action to repay disallowed costs, make financial adjustments, or take other action. If the auditee has not completed corrective action, a timetable for follow-up should be given. Prior to issuing the management decision, the Federal agency or pass-through entity may request additional information or documentation from the auditee, including a request for auditor assurance related to the documentation, as a way of mitigating disallowed costs. The management decision should describe any appeal process available to the auditee.

(b)As provided in Section .400(c)(5), a Federal awarding agency is responsible for issuing a management decision for findings that relate to Federal awards it makes to recipients....

(d) Time requirements. The entity responsible for making the management decision shall do so within six months of receipt of the audit report. Corrective action should be initiated within six months after receipt of the audit report and proceed as rapidly as possible....

Schedule of Audit Findings

Washington State Migrant Council Yakima County November 1, 1996 through October 31, 1997

8. The guidance for audits of organizations that receive federal and state awards should be improved.

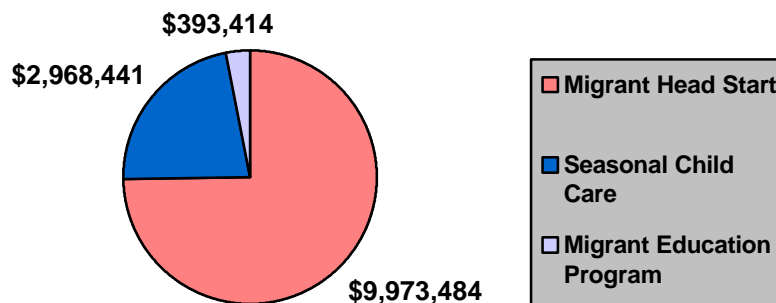
Background

As described in the Description of the Blended Resources Program section of this report, the Washington State Migrant Council has developed a method of combining the resources received from three programs and agencies to operate a single program. This program delivers services to basically the same population of children from both migrant and seasonal farm worker families during the same period of time. These programs are as follows:

<u>Program</u>	<u>Agency</u>
Migrant Head Start (MHS)	U.S. Department of Health and Human Services (HHS)
Seasonal Child Care (SCC)	Department of Social and Health Services (DSHS)
Migrant Education Program (MEP)	Office of the Superintendent of Public Instruction (OSPI)

For the fiscal year ended October 31, 1997, the Council spent a total of \$13,335,339 in the three programs where it combined resources, or almost 63 percent of its total disbursements during this period of time. Individual program expenditures were \$9,973,484 (MHS), \$2,968,441 (SCC), and \$393,414 (MEP). This chart depicts these expenditures:

**Total Expenditures for the Blended Resources Program
Fiscal Year 1997**



Total \$13,335,339

The Single Audit Act of 1984; Single Audit Act Amendments of 1996; and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, establish audit requirements and define federal and pass-through responsibilities for implementing and monitoring the requirements for organizations that receive federal awards. An audit performed pursuant to the Circular must express an opinion as to whether major programs are being administered in compliance with laws and regulations.

Description of Condition

OMB Circular A-133 includes guidance for the audit of a cluster of programs, which is defined as closely related programs sharing common compliance requirements. The Circular does not permit closely related programs with dissimilar compliance requirements to be audited as a cluster. The Circular identifies several clusters and allows each state to identify other clusters of federal awards it provides to subrecipients. However, any clusters identified by the states must also have common compliance requirements. For Single Audit purposes, states do not have the option of identifying programs with dissimilar compliance requirements as a cluster.

In addition, the Office of Financial Management (OFM) has not established procedures for state agencies to follow when organizations such as the Council combine closely related programs that are funded partially or completely by the state.

Cause of Condition

Following due process, the drafters of the Single Audit Act and OMB Circular A-133 conducted studies and consulted with outside expert sources to determine what requirements should be included. According to OMB, there were no suggestions from any of those involved in this process that a blended resources program, with funding provided by several federal awards with dissimilar compliance requirements, should be audited as a cluster.

Further, OFM has not established procedures for state-funded programs because of a lack of resources.

Effect of Condition

While agencies and the contract auditor reviewed major programs separately, these agencies may not have had a complete picture of the three federal and state grants where the Council combined funds into a single program (see finding number 1).

Recommendations

We recommend the OMB determine whether any revisions to the Single Audit Act and Circular A-133 are needed. When determining major programs for audit purposes, OMB should consider situations where organizations such as the Council group closely related programs that have dissimilar compliance requirements.

We also recommend the Office of Financial Management establish guidance for state agencies to follow when organizations such as the Council blend resources from several agencies to deliver services.

OMB's Response

OMB does not respond to recommendations included in audits of non-Federal entities.

OFM's Response

In the case of the Council, the blending of resources became an issue not because of lack of guidance, but because the Council overrode internal controls and the Single Audit failed to report on the lack of operational internal controls. Extensive guidance related to the administration of federal awards already exists at the federal level through circulars and grant guidelines. At the state level, OFM continuously updates policy language and provides on-going training to aid state agencies in meeting their subrecipient monitoring responsibilities.

However, we agree that it would have been beneficial for the awarding federal and state agencies to have coordinated service delivery by the Council to ensure all parties agreed on what services were to be provided by what funding source.

Even so, identifying organizations like the Council, which are funded by multiple agencies, remains a formidable task because there is no statewide system for collecting and reporting data on contracts. DSHS alone is responsible for 60,000 social service contracts.

The 1998 Washington State Legislature recognized this problem when it established the Task Force on Agency Vendor Contracting to study state social services contracting practices and make recommendations for improving the management of fee-for-service and client-services contracts with nonprofit organizations. The Task Force is currently working with key legislators, state agency personnel, nonprofit organizations, and other interested parties to assess how the state can effectively and efficiently address situations where multiple state agencies provide funding to organizations such as the Council. The Task Force has a November 1, 1999, reporting deadline. OFM will work with the Task Force in the effort to devise a workable, affordable approach to coordinating multi-agency funding situations.

Auditor's Concluding Remarks

We appreciate OFM's observations relative to this finding. Further, we commend OFM's commitment to the work of the Task Force on Agency Vendor Contracting.

There is a growing trend at the federal and state level to blend resources in achieving program service delivery. We support this trend. However, there is currently a lack of administrative and financial guidance on this practice.

Once this report is issued, the Washington State Auditor's Office will be transmitting a letter to the U.S. Office of Management and Budget outlining the need for this administrative and audit guidance.

Applicable Laws and Regulations

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, establishes a focal point for policy matters related to the Single Audit Act. The authorizing memorandum for the Circular states in part:

7. OMB Responsibilities. OMB will review Federal agency regulations and implementation of this Circular, and will provide interpretations of policy requirements and assistance to ensure uniform, effective and efficient implementation.

OMB Circular A-133, Subpart A - General, Section .105, provides guidance to states regarding programs that have been grouped together by organizations. It states in part:

....Cluster of programs means a grouping of closely related programs that share common compliance requirements. The types of clusters of programs are research and development (R&D), student financial aid (SFA), and other clusters. "Other clusters" are as defined by the Office of Management and Budget (OMB) in the compliance supplement or as designated by a State for Federal awards the State provides to its subrecipients that meet the definition of a cluster of programs. When designating an "other cluster," a State shall identify the Federal awards included in the cluster and advise the subrecipients of compliance requirements applicable to the cluster....A cluster of programs shall be considered as one program for determining major programs.